Office-Supreme Court, U.S.
FILED
FEB 28 1962
JOHN F. DAVIS, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. [redacted] '73

PEOPLE OF THE STATE OF CALIFORNIA and
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
Petitioners,

vs.

FEDERAL POWER COMMISSION,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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SUBJECT INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement of the Case	3
A. Original Proceedings Before the Commission and the Courts	3
B. Remanded Proceedings Before the Commission	4
C. The Presiding Examiner's Decision	5
D. The Commission's Opinion	5
E. Proceeding in the Court Below	8
Reasons for Granting the Writ	10
A. The Decision of the Court Below and the Opinion of the Commission are Contrary to the Intent and Purpose of the Natural Gas Act	12
1. The Policy Underlying the Act Has Been Contradicted	12
2. The Act Calls for a Standard of Just and Reasonable Rates	13
3. The Just and Reasonable Standard Has Been Disregarded	15
4. Consumer Protection Requires Regulation Not Experimentation	20
B. The Decision of the Court Below and the Opinion of the Commission Fail to Provide Lawful Regulation of Producers	23
1. The Cost of Service Method Must Be Used Until Replaced by Another Lawful Method	23
2. Spiral Escalation Clause Increases Are Unlawful in a Regulatory Setting	25

Page

C. The Decision of the Court Below and the Opinion of the Commission Overlook the National Importance and Significance of This Proceeding 27

1. The Importance of Natural Gas Regulation to California Consumers 27

2. The National Importance and Significance of Producer Regulation 28

Conclusion 30

Appendices

TABLE OF AUTHORITIES CITED

Court Cases	Pages
Atlantic Refining Company v. Public Service Commission of the State of New York, 360 U.S. 378 (1959)	13, 15
Bel Oil Corporation v. Federal Power Commission, 255 F.2d 548 (5th Cir. 1958), cert. denied 358 U.S. 804 (1958)	5, 24
City of Detroit, Michigan v. Federal Power Commission, 230 F.2d 810 (D.C. Cir. 1955), cert. denied 352 U.S. 829 (1956)	5, 7, 21, 23, 24
City of Yonkers v. United States, 320 U.S. 685 (1944)	19
Colorado-Wyoming Gas Company v. Federal Power Commission, 324 U.S. 626 (1945)	16
Episcopal Theological Seminary v. Federal Power Commission, 269 F.2d 228 (D.C. Cir. 1959), cert. denied 361 U.S. 895 (1959)	24
Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944)	5, 13, 15, 23, 24
Forest Oil Corporation v. Federal Power Commission, 263 F.2d 622 (5th Cir. 1959)	5, 24
Humphrey's Executor v. United States, 295 U.S. 602 (1935)	13
Mahler v. Eby, 264 U.S. 32 (1924)	19
Minneapolis Gas Company v. Federal Power Commission, 294 F.2d 212 (D.C. Cir. 1961)	18
Morgan v. United States, 298 U.S. 468 (1936)	21
Ohio Bell Telephone Company v. Public Utilities Commission of Ohio, 301 U.S. 292 (1937)	21
Office Employees International Union v. National Labor Relations Board, 353 U.S. 313 (1957)	19
Phillips Petroleum Company v. Wisconsin, 347 U.S. 672 (1954)	4, 5, 11
Schaffer Transportation Company v. United States, 355 U.S. 83 (1957)	19
Smith v. Interstate Commerce Commission, 245 U.S. 33 (1917)	19
State of Wisconsin v. Federal Power Commission, 205 F.2d 706 (D.C. Cir. 1953), affirmed 347 U.S. 672 (1954)	4, 11

FEDERAL POWER COMMISSION CASES

	Pages
Associated Oil and Gas Co., 17 FPC 174 (1956)	14
Associated Oil and Gas Co., 17 FPC 199 (1956)	14
Bateman Drilling Co., 20 FPC 341 (1958)	14
Bayview Oil Co., 21 FPC 405 (1959)	14
BBM Drilling Co., 20 FPC 725 (1958)	14
Christie, Mitchell & Mitchell, 15 FPC 751 (1956)	14
Continental Oil Co., 15 FPC 735 (1956)	14
Continental Oil Co., FPC Opinion No. 351, January 22, 1962	24
Crow Drilling Co., Inc., 17 FPC 226 (1957)	14
Davidor & Davidor, 15 FPC 1936 (1956)	14
Delhi-Taylor Oil Corp., 18 FPC 375 (1957)	14
Fair, Ralph H., 20 FPC 810 (1958)	15
Forest Oil Corp, 17 FPC 586 (1957)	14
Gilfring Oil Co., 20 FPC 770 (1958)	15
Harper Oil Co., 17 FPC 803 (1957)	14
Hunt, H. L., 19 FPC 748 (1958)	14
Hunt, Hassie, Trust, 21 FPC 37 (1959)	14
Lyman, C. V., 22 FPC 557 (1959)	15
Monsanto Chemical Co., 22 FPC 1077 (1959)	14
Murphy Corp., 25 FPC 334 (1961)	14, 15
Negley, William, 17 FPC 550 (1957)	14
Ohio Fuel Gas Co., 15 FPC 1623 (1956)	14
Olin Gas Transmission Corp., 17 FPC 685 (1957)	14
Pan American Petroleum Corp., 19 FPC 463 (1958)	14
Pan American Petroleum Corp., 19 FPC 519 (1958)	14
Phillips Petroleum Co., 10 FPC 246 (1951)	2, 4
Sears, H. G., 18 FPC 244 (1957)	14
Sinclair Oil & Gas Co., 22 FPC 53 (1959)	14

	Pages
Southwest Gas Producing Co., 18 FPC 304 (1957)	14
Sun Oil Co., 17 FPC 174 (1956)	14
Sun Oil Co., 19 FPC 973 (1958)	14
Union Oil Co. of California, 16 FPC 100 (1956)	14
Union Oil Co. of California, 17 FPC 89 (1957)	21
United Carbon Co., 25 FPC 181 (1961)	14
Western Natural Gas Co., 23 FPC 235 (1960)	15
Wunderlich Development Co., 15 FPC 692 (1956)	14

STATUTES

Administrative Procedure Act (Act of June 11, 1946, c. 324):	
Sec. 5 (60 Stat. 239; 5 U.S.C. § 1004)	3, 21
Sec. 8(b) (60 Stat. 242; 5 U.S.C. § 1007(b))	3, 19
Federal Power Act (Act of June 10, 1920, c. 556, 49 Stat. 856, 16 U.S.C. § 825(f) (1935))	19
Natural Gas Act (Act of June 21, 1938, c. 556):	
Sec. 4(a) (52 Stat. 821; 15 U.S.C. § 717(a))	3, 12
Sec. 4 (52 Stat. 822; 15 U.S.C. § 717c)	3, 15
Sec. 4(a) (52 Stat. 822; 15 U.S.C. § 717c(a))	13
Sec. 4(e) (52 Stat. 822; 15 U.S.C. § 717c(e))	4, 5, 6, 8, 9, 11, 14, 15, 19, 20, 25
Sec. 5 (52 Stat. 823; 15 U.S.C. § 717d)	3, 15
Sec. 5(a) (52 Stat. 823; 15 U.S.C. § 717d(a))	4, 5, 7, 8, 9, 11, 14, 15, 17, 19, 20
Sec. 19(b) (52 Stat. 831, as amended 15 U.S.C. § 717r(b) (1958))	2, 3, 8
Public Utility Holding Company (Act of August 26, 1935, c. 687, 49 Stat. 831, as amended 15 U.S.C. § 79r (1949))	19
Securities Exchange Act (Act of June 6, 1934, c. 404, 48 Stat. 899, as amended 15 U.S.C. § 780 (1949))	19

FEDERAL POWER COMMISSION RULES AND REGULATIONS

FPC Rules and Regulations:	
Sec. 1.18, 18 C.F.R. § 1.18	16
Sec. 1.13-1.26, 18 C.F.R. §§ 1.13-1.26	21

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vs.

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Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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The Petitioners, the People of the State of California and the Public Utilities Commission of the State of California, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in the above-entitled case on November 30, 1961.

OPINIONS BELOW

The opinion of the Court of Appeals, Docket Nos. 16175, 16177 and 16180, decided November 30, 1961 (Appendix A), is not yet reported. The Federal Power Commission's Opinion and Order Determining Cost of Service and Terminating Proceedings, issued on September 28, 1960 (R. 32643-32709) and its Order Denying Applications for Rehearing, Amending Opinion and Rejecting Application for Rehearing, issued on Novem-

ber 25, 1960 (R. 32897-32904), in the proceeding entitled *In the Matters of Phillips Petroleum Company*, Docket Nos. G-1148, *et al.*, are reported at 24 F.P.C. 537 (1960) and 24 F.P.C. 1008 (1960).

JURISDICTION

The judgment of the Court of Appeals was entered on November 30, 1961. Petitioners herein did not petition for rehearing before the Court of Appeals.[1] Consequently, the court's judgment became final on December 15, 1961. The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act.[2]

QUESTIONS PRESENTED

1. Where Sections 4 and 5 of the Natural Gas Act provide a just and reasonable standard for the testing of rates of natural gas producers, may the Federal Power Commission terminate proceedings under said statutes and allow the rates at issue to become effective without a finding relative to their justness and reasonableness?
2. Where the Court of Appeals, affirmed by this Court, has ordered the fixing of rates in accordance with the just and reasonable standard, may the Federal Power Commission, in remanded proceedings, terminate the proceedings without fixing the rates as so ordered?
3. Where Sections 4 and 5 of the Natural Gas Act provide for hearings for the fixing of just and reasonable rates, may the Federal Power Commission promulgate a list of rate levels as just and reasonable when said list was developed without notice, hearings, and the taking of evidence?

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[1]Rule 26 of the United States Court of Appeals for the District of Columbia Circuit allows fifteen days after judgment or decision to petition for rehearing.

[2]Act of June 21, 1938, c. 556, § 19, 52 Stat. 831, as amended 15 U.S.C. 717r (b) (1958).

4. Where spiral escalation clauses in a natural gas producer's contracts are unacceptable in principle and unlawful in a regulatory setting, may the Federal Power Commission refuse to reject rate increase filings based thereon?
5. Where the cost of service method is the only approved, existing, and workable means of regulating natural gas producers, may the Federal Power Commission abandon said method without substituting a method which will provide lawful regulation while new procedures are being developed?
6. Where the Congress has provided for the regulation of natural gas producers under the Natural Gas Act, may the Federal Power Commission by interminable delay prevent said regulation from becoming a reality and substitute further experimentation for presently valid regulation?

STATUTES INVOLVED

The relevant parts of the statutes involved are set forth in the Appendix B. Citations to them are:

1. Administrative Procedure Act, Act of June 11, 1946, c. 324, 60 Stat. 235, 5 U.S.C. § 1000; § 5, 5 U.S.C. §1004; § 8(b), 5 U.S.C. § 1007(b).

2. Natural Gas Act, Act of June 21, 1938, c. 556, 52 Stat. 821, as amended 15 U.S.C. § 717; § 1(a), 15 U.S.C. § 717(a); § 4, 15 U.S.C. § 717c; § 5, 15 U.S.C. § 717d; § 19(b), 15 U.S.C. § 717(r)(b).

STATEMENT OF THE CASE

A. Original Proceedings before the Commission and the Courts.

On October 28, 1948, the Federal Power Commission (Commission) instituted, on its own motion, an investigation to determine (1) whether Phillips Petroleum Company (Phillips) was a natural gas company within the Commission's jurisdiction, and (2) if so, whether Phillips' existing rates were unjust and

unreasonable. (R. 26148-50). This investigation, designated Docket No. G-1148, was initiated pursuant to Section 5(a) of the Natural Gas Act.[3]

Hearings commenced in April, 1951, and were directed solely to the jurisdictional issue. In August, 1951, the Commission found that Phillips was not a natural gas company within the meaning of the Act and, in accordance with this finding, terminated the investigation. *In the Matter of Phillips Petroleum Company*, 10 FPC 246 (1951).

The United States Court of Appeals for the District of Columbia Circuit, in May, 1953, reversed the Commission and ordered it to "fix the rates at which these sales [by Phillips] are made." *State of Wisconsin v. Federal Power Commission*, 205 F.2d 706, 712 (D.C. Cir. 1953). This Court, in June, 1954, affirmed the judgment of the Court of Appeals. *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 (1954).

B. Remanded Proceedings Before the Commission.

In compliance with the judicial mandate the Commission, in November, 1954, resumed its investigation (R. 32931-32). This time the investigation would be focused on the second issue—the justness and reasonableness of Phillips' rates.

By later orders the Commission consolidated with the Section 5(a) investigation twelve docketed rate increase filings of Phillips under Section 4(e) of the Act.[4]

Hearings commenced in June, 1956, and were conducted intermittently before a presiding examiner until December, 1957. Therefore, the Commission's first effort to regulate the rates of a major natural gas producer began eight years after the original order instituting the investigation and eighteen years after the enactment of the Natural Gas Act. The hearings consumed eighty-two days and produced over 25,000 pages of record.

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[3] 52 Stat. 823 (1938); 15 U.S.C. § 717d(a).

[4] 52 Stat. 822 (1938); 15 U.S.C. § 717c(e).

C. The Presiding Examiner's Decision.

The Presiding Examiner issued his decision in April, 1959, sixteen months after the conclusion of the hearings. (R. 31324-654). Following an established line of decisions beginning with *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944), and including *City of Detroit, Michigan v. Federal Power Commission*, 230 F.2d 810 (D.C. Cir. 1955), cert. denied 352 U.S. 829 (1956), *Bel Oil Corporation v. Federal Power Commission*, 255 F.2d 548 (5th Cir. 1958), cert. denied 358 U.S. 804 (1958), and *Forest Oil Corporation v. Federal Power Commission*, 263 F.2d 622 (5th Cir. 1959), the examiner decided that conventional cost of service, or rate base method, was the lawful way to test the justness and reasonableness of Phillips' rates. (R. 31340-47). All parties, including Phillips, had agreed to and had participated in the conduct of the proceeding along cost of service lines.[3] The examiner stated that "the length and complexity of the instant *Phillips* proceeding cannot fairly be regarded as representative of the situation which will be commonly encountered in future rate proceedings * * *." (R. 31352).

The decision called upon Phillips to calculate new rates, based on a cost of service of $57,280,218, for each of its current jurisdictional rate schedules. These "calculated rates", if approved by the Commission, would constitute maximum rates for the consolidated Section 4(e) filings.

The examiner's decision demonstrates that just and reasonable rates can be developed for a producer of natural gas—in this case the nation's largest—on a cost of service basis.

Oral argument was held before the Commission in October, 1959 (R. 16894-7140).

D. The Commission's Opinion.

In September, 1960, the Commission issued Opinion No. 338 (R. 32643-709) which terminated ten of the twelve Section 4(e) proceedings and the Section 5(a) investigation. The Commis-

[3]Thirty-one parties intervened in the proceeding before the Commission.

sion, while not deciding the issue of the justness and reasonableness of Phillips' rates, discharged the company from any obligation to make refunds.

The Commission, using the cost of service approach, found that Phillips' revenues for the test year 1954 fell about $10,000,000 below the $55,548,054[6] cost of service which the Commission computed for that year. (R. 32693). Because of this deficiency in revenue, the Commission excused Phillips from making refunds respecting the Section 4 (e) increases. This action was taken, the Commission said, because nine of the ten dockets had been superseded by new filings for even higher rates and that the now "locked-in" rates should be bypassed. The Commission stated: "[I]t would appear that on the basis of the present record that Phillips' costs probably exceed its revenues at least up through the year 1958, after which very substantial further rate increases were filed by Phillips." (R. 32695).

Upon this assumption that Phillips did not recover its cost of service through 1958, the Commission invited Phillips to move to dismiss the Section 4 (e) proceedings "on the theory that little or nothing would be accomplished if hearings were held and a determination of Phillips' costs in each case were made." (R. 32695).

Three of the Section 4 (e) dockets concerned rate increase filings based on the activation of spiral escalation clauses.[7] Docket No. G-11217, involving a sale to El Paso Natural Gas Company, and Docket No. G-10883, involving a sale to Panhandle Eastern Pipe Line Company, were left open pending the final determination of the rates of these pipeline companies in other proceedings. However, the rate increase in Docket No. G-10793, covering a sale to Michigan-Wisconsin Pipe Line Company, was approved by the Commission. (R. 32695). By keeping the former open only on the issue of the amount of increase and by approving the latter, the Commission placed a stamp of legality on spiral escalation clauses.

[6]On rehearing, this figure was changed to $54,525,315. (R. 32901).

[7]Spiral escalation clauses are discussed on pages 25-27.

The Section 5 (a) investigation was terminated because the Commission did not "think that it is appropriate to set rates for the future on the basis of this record in this hearing that terminated December 18, 1957, utilizing a test year of 1954 or 1956 * * *." (R. 32656).

In using the cost of service approach the Commission said that this was "clearly a lawful way to determine rates for Phillips as illustrated by the *City of Detroit* case, and under the present record is the only possible method, and therefore we shall make every effort to reach a result by this means." (R. 32655). Furthermore, the Commission said: "In the present proceedings we are as a matter of law permitted to reach results by this method." (R. 32655). However, in the same breath, it also said that such an approach was not a sensible, or even a workable, method of fixing rates for producers of natural gas. (R. 32647).

The Commission used its opinion to announce that it was considering the possibility of pricing natural gas as a commodity, on an area basis, thereby avoiding the necessity of regulating producers individually. (R. 32647-54). It made reference to its Statement of General Policy No. 61-1, issued simultaneously with the opinion. (R. 32710-13). The Statement sets maximum price levels for initial and increased rates to be used as guides in determining whether proposed initial rates should be certificated without condition and whether proposed rate changes should be accepted or suspended. (R. 32710).

These price levels were promulgated, presumably under the authority of the Natural Gas Act, without notice, hearings, and the taking of evidence. They were intended to be guides in all subsequent producer rate matters pending the outcome of the Commission's experiments in the area, or commodity, pricing of gas.

Petitioners filed a timely petition for rehearing (R. 32763-71) which was denied by the Commission in November, 1960. (R. 32897-904).

E. Proceeding in the Court Below.

Pursuant to Section 19 (b) of the Natural Gas Act Petitioners obtained court review of the Commission's orders.

The court, Judge Fahy dissenting with partial concurrence, upholds the Commission's position that the cost of service method of regulation is not a sensible, or even workable, means of fixing producer rates. (App. A, p. 5). It points out that cost of service, by limiting producers to a fair return on investment, penalizes the efficient and fortunate producer who keeps his costs low. The method itself, the majority says, produces problems in the allocation of costs between gas and oil and is a burden on the administrative agency. Nevertheless, the majority agrees with Phillips' cost of service as computed by the Commission. (App. A, p. 10).

On the Commission's termination of the Section 4 (e) dockets, the majority of the court says that the Commission's act was a clear decision, after elaborate findings, upon the issue of refunds. (App. A, p. 11). The majority further says that "[w]hether the Commission should have preceded its ultimate conclusion of no-refund with an intermediate conclusion of justness and reasonableness in the rates at issue, and whether it properly added the termination order to its decisive finding, seem to us to be immaterial queries." (App. A, p. 11).

The majority's opinion makes no reference to an absence of a finding on the justness and reasonableness of Phillips' *existing* jurisdictional rates in the Section 5 (a) investigation. It does point out that the Commission "abandoned" the investigation because it could not establish rates for the *future* by the inadequate cost of service method. (App. A, p. 12). However, the opinion recognizes that, under Section 5 (a), future rates are determined only after the Commission "finds a rate unjust, unreasonable, unduly discriminatory or preferential * * *." (App. A, p. 14).

The court assumes, as did the Commission, that Phillips' costs have exceeded revenues through 1958. This assumption is made even though the court notes that the cost of service adopted was for the single test year 1954. (App. A, p. 9).

Using this assumption, the opinion speaks of an "interim period" between January 1, 1959, and the date when the Commission, or the courts, reach a final determination respecting the area pricing of gas. (App. A, p. 13). It is acknowledged that this period may last as long as fourteen years. (App. A, p. 13). To carry on its duties during this period, the majority says that the Commission may rely on the rate levels in its Statement of General Policy No. 61-1. The court puts the problem this way:

> "Can [the Commission] adopt upon the basis of its own expertise and its files, without a record made in the open in respect to the specific subject matter in issue, and without hearing, a set of guide lines by which it will be controlled in its regulatory functions during an interim period, while it is attempting to perfect a suitable system for permanent regulation? We think it can." (App. A, p. 13).

On spiral escalation clauses the court says:

> "Wisconsin and California contend that the Commission should now declare these escalator clauses to be illegal and void as against public policy. As a matter of fact the Commission has declared these clauses to be against the public interest and that they should be held inoperative. But, the Commission says, insofar as these clauses of Phillips are concerned, action of the sort demanded by Wisconsin and California is premature. Action on these clauses, it says, should await action on the pending cases which in orderly processes present the problem for decision. We agree with the Commission." (App. A, p. 18).

The court makes no reference to the spiral escalation clause in Docket No. G-10793, which docket was not left open but was terminated along with the other Section 4 (e) proceedings.

The dissenting opinion was unable to agree that the order of the Commission terminating the Section 4 (e) and the Section 5 (a) proceedings should be affirmed. The dissent says: "I think the cases should be remanded to the Commission for decision." (App. A, p. 18). On the cost of service issue, Judge Fahy notes:

> "In the same breath as it were in which it describes the unworkability of the cost of service method the Commission itself accepts that precise method in finding that no refunds are to be required in the Section 4 (e) proceedings * * *." (App. A, pp. 18-19).

Speaking of the Commission's proposal to establish commodity pricing on an area basis, he says:

> "It is one thing to say, as the Commission does, that the area method should hereafter be adopted, or even adopted in other cases which have not proceeded as far as those before us. It is quite another thing to say that the latter should not be decided under the standards of the Act because the area method was not used in preparing the record. Unless decided Phillips' challenged rates are left undetermined under the standards of the Act since 1948, and apparently will continue to remain undetermined until some future day when new proceedings, now in an inchoate status with no end in sight, are concluded." (App. A, p. 20).

The dissent insists that the primary purpose of the Natural Gas Act, consumer protection, can be best achieved by remanding the proceeding to the Commission, and supplementing the record as necessary. The dissent says:

> "The absence of a decision on the issue of justness and reasonableness of rates has the effect of leaving all rates subsequent to 1954 untested under the standards of the Act. Substance is not achieved merely by finding whether or not refunds were due on the basis of the 1954 data. A finding in that regard should not be independent of a finding of just and reasonable rates. The former should follow from the fact that the just and reasonable rates are not exceeded by those in effect." (App. A, p. 21).

The dissent concurred with the majority only as to the prematurity of the request for action relating to the spiral escalation clauses.

REASONS FOR GRANTING THE WRIT

Circuit Judge Prettyman characterizes this case as a controversy concerning "major problems of general application." (App. A,

p. 2). This statement is recognition that not only is the regulation of a single natural gas producer involved, but also the regulation of producers generally. The instant case presents the proper situation for this Court, having already ordered the regulation of producers under the Natural Gas Act, to decide for the first time whether or not they, in fact, are being regulated.

The approval by the majority of the court below of the Commission's termination of several rate increase proceedings and a general rate investigation of the nation's largest producer of natural gas, without a decision by the Commission on the basic and ultimate issue before it, is an unjustifiable departure from statutory and judicial mandates.

The statutory mandate is found in both Section 4(e) and Section 5(a). These statutes call upon the Commission to test rates using a standard of "just and reasonable." Disregarding such standard, the Commission allows Phillips' rates to become effective, as if just and reasonable, because (1) Phillips should not be required to make refunds and, (2) the Commission should not be required to use existing procedures for testing rates.

The judicial mandate, which the Commission also disregards, was issued by the same court and affirmed by this Court in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 (1954). The Court of Appeals instructed the Commission to "fix the rates at which these sales [by Phillips] are made." *State of Wisconsin v. Federal Power Commission*, 205 F.2d 706, 712 (D.C. Cir. 1953). Nevertheless, the Commission does not fix Phillips' rates but allows existing rates and new rates to remain effective, as if just and reasonable, without a finding relative to their justness and reasonableness.

The court below and the Commission further err in treating mere guideline rates, established without notice, hearing, and the taking of evidence, and based on field prices, as just and reasonable rates. The determination that a decision on the legality of spiral escalation clauses would be premature is likewise incorrect. The Commission's opinion gave legal effect to these clauses and the court below should have reviewed this issue.

The decision of the majority of the court below to uphold the Commission's rejection of the conventional cost of service approach to rate regulation in future producer cases is erroneous. The instant proceeding is developed through a cost of service method, and, until a new method is designed, cost of service is the only approved, existing, and workable means of carrying out producer regulation.

The court below and the Commission suspend producer regulation until an area, or commodity, pricing of gas is adopted, assuming it is adopted. *No lawful provision is made for regulation during this interim period of development.*

The problems created by the decision of the majority of the court below and by the opinion of the Commission are many, and call for immediate resolution. The law as it exists today with regard to the regulation of natural gas producers is uncertain. A decision in this area by this Court is needed.

The issues presented are heightened by the social and economic interests of the consumers here involved, and by the national importance and significance of this proceeding.

A. The Decision of the Court Below and the Opinion of the Commission Are Contrary to the Intent and Purpose of the Natural Gas Act.

1. THE POLICY UNDERLYING THE ACT HAS BEEN CONTRADICTED.

In Section 1(a) of the Natural Gas Act[5] Congress makes known the compelling reason for federal regulation of the natural gas industry:

> "As disclosed in reports of the Federal Trade Commission made pursuant to Senate Resolution 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is *affected with a public interest*, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate commerce is necessary *in the public interest*." (Emphasis supplied)

[5] 52 Stat. 821 (1938); 15 U.S.C. § 717(a).

In order to serve best the public interest Congress has adopted a policy of consumer protection under the Act. The policy is discussed by this Court in *Atlantic Refining Company v. Public Service Commission of the State of New York*, 360 U.S. 378, 388 (1959):

> "The purpose of the Natural Gas Act was to underwrite just and reasonable rates to consumers of natural gas. * * * The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."

This statement is a reiteration of this Court's view in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 611 (1944). There it is said that the primary aim of the Act is "to protect consumers against exploitation at the hands of natural gas companies."

Congress has delegated to the Commission the duty and responsibility of protecting the consumers of natural gas. As an agency of Congress it is "charged with the enforcement of no policy except the policy of the law." *Humphrey's Executor v. United States*, 295 U.S. 602, 624 (1935). The Commission is obligated to observe the mandate of Congress provided in the Act, as interpreted by the courts.

2. THE ACT CALLS FOR A STANDARD OF JUST AND REASONABLE RATES.

What standard does Congress provide to enable the Commission to protect consumers? Section 4(a)[2] sets forth the only standard:

> "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission * * * *shall be just and reasonable*, and any such rate or charge that is not *just and reasonable* is hereby declared to be *unlawful*." (Emphasis supplied).

Accordingly, the only lawful rates are those which meet the standard of just and reasonable.

[2] 52 Stat. 822 (1938); 15 U.S.C. § 717c(a)

Following a scheme of consumer protection through the assurance of just and reasonable rates, Congress included Sections 4(e) and 5(a) within the Act. Section 4(e) allows the Commission to suspend proposed rate increases for a maximum period of five months, and then to enter upon a hearing concerning the lawfulness, or justness and reasonableness, of such increases, deciding that issue "as speedily as possible." Upon expiration of the suspension period the rates become effective but subject to refund to the extent they may be found later to be unjust and unreasonable. Section 5(a) gives the Commission the power to investigate existing rates so as to determine whether or not they are just and reasonable. If found just and reasonable they are lawful rates; if found unjust and unreasonable the Commission must determine the lawful rates.

With the exception of the instant proceeding, in the Section 4(e) producer rate cases which have had full hearings and have been decided, the Commission has either made specific findings relative to the justness and reasonableness of rates, or has dismissed the proceedings because the producers failed to make a showing of justness and reasonableness.[10] Likewise, in completed

[10] *Wunderlich Development Co.*, 15 FPC 692 (1956); *Continental Oil Co.*, 15 FPC 735 (1956); *Christie, Mitchell & Mitchell*, 15 FPC 751 (1956); *Davidor & Davidor*, 15 FPC 1936 (1956); *Ohio Fuel Gas Co.*, 15 FPC 1623 (1956); *Union Oil Co. of California*, 16 FPC 100 (1956); *Sun Oil Co.*, 17 FPC 174 (1956); *Associated Oil and Gas Co.*, 17 FPC 174 (1956); *Associated Oil and Gas Co.*, 17 FPC 199 (1956); *Crou Drilling Co., Inc.*, 17 FPC 226 (1957); *William Negley*, 17 FPC 550 (1957); *Forest Oil Corp.*, 17 FPC 586 (1957); *Olin Gas Transmission Corp.*, 17 FPC 685 (1957); *Harper Oil Co.*, 17 FPC 803 (1957); *H. G. Sears*, 18 FPC 244 (1957); *Southwest Gas Producing Co.*, 18 FPC 304 (1957); *Delhi-Taylor Oil Corp.*, 18 FPC 375 (1957); *Pan American Petroleum Corp.*, 19 FPC 463 (1958); *Pan American Petroleum Corp.*, 19 FPC 519 (1958); *H. L. Hunt*, 19 FPC 748 (1958); *Sun Oil Co.*, 19 FPC 973 (1958); *Bateman Drilling Co.*, 20 FPC 341 (1958); *BBM Drilling Co.*, 20 FPC 723 (1958); *Hassie Hunt Trust*, 21 FPC 37 (1959); *Bayview Oil Co.*, 21 FPC 405 (1959); *Sinclair Oil & Gas Co.*, 22 FPC 53 (1959); *Monsanto Chemical Co.*, 22 FPC 1077 (1959); *United Carbon Co.*, 25 FPC 181 (1961); *Murphy Corp.*, 25 FPC 331 (1961).

producer Section 5(a) investigations the Commission has made specific findings relative to the justness and reasonableness of existing rates.[11] Therefore, until the instant case, this was the test applied by the Commission without question.

In the *Atlantic Refining* case[12] this Court states that the purpose of the Act is "to underwrite just and reasonable rates to consumers of natural gas." And in the *Hope* case[13] this Court speaks of the "statutory standard of 'just and reasonable'."

From the literal reading of the statutes, from the past decisions of the Commission, and from the interpretations of this Court, it is evident that the basic and ultimate issue in a proceeding under either Section 4 or Section 5 is the justness and reasonableness of the rates involved. Such is the standard devised by Congress; such is the standard which the Commission must apply in testing increased rates, investigating existing rates, and establishing future rates.

3. THE JUST AND REASONABLE STANDARD HAS BEEN DISREGARDED.

The instant proceeding presents the first and only occasion in which the Commission has not made a just and reasonable determination, or required such a showing, in a Section 4(e) proceeding. This disregard of the statutory standard is supported by the majority of the court below. The court states that the only question of substance involved in the Section 4(e) dockets is "whether refunds should be made." (App. A, p. 10). Furthermore, the court says:

> "Whether the Commission should have preceded its ultimate conclusion of justness and reasonableness in the rates at issue, and whether it properly added the termination order to its decisive finding, seems to us to be immaterial queries." (App. A, p. 11).

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[11] *Gilfring Oil Co.*, 20 FPC 770 (1958); *Ralph E. Fair*, 20 FPC 810 (1958); *C. V. Lyman*, 22 FPC 557 (1959); *Western Natural Gas Co.*, 23 FPC 235 (1960); *Murphy Corp.*, 25 FPC 334 (1961).

[12] *Atlantic Refining Company v. Public Service Commission of the State of New York*, 360 U.S. 378, 388 (1959).

[13] *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 602 (1944).

Such a position replaces the just and reasonable finding, demanded by the statute for consumer protection, with a conclusionary statement of whether or not the producer should make refunds.[11] This is analogous to a judge sentencing a defendant without a finding as to his guilt.

Obviously, entirely different factors may be involved in refund accounting than are involved in deciding whether particular rates are just and reasonable. The Commission, for instance, has made provision for offers of settlement whereby natural gas companies may negotiate the extent of the refunds to be paid. FPC Rules and Regulations, Sec. 1.18; 18 C.F.R. § 1.18. Moreover, no rational determination of refunds can be made unless a line is drawn at a lawful level. The majority below and the Commission have excused Phillips from a refund obligation without finding whether the rates being collected were at a lawful level. *This question of the lawfulness of rates was the basic and ultimate issue before the Commission.*

The necessity for findings upon basic and ultimate issues has been discussed by this Court in *Colorado-Wyoming Gas Company v. Federal Power Commission*, 324 U.S. 626, 631, 634 (1945):

> "Here as in the cases of Canadian and Colorado Interstate the findings of the Commission leave much to be desired. The findings are general and incorporate by reference the staff exhibits, on which reliance is put for the subsidiary findings. * * *
>
> "The review which Congress has provided for these rate orders is limited. Section 19 (b) 15 USCA Sec. 717r (b), 4 FCA title 15, Sec. 717r (b) says that the 'finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.' But we must first know what the 'finding' is before we can give it conclusive weight. We have repeatedly emphasized the need for clarity and completeness in the basic or essential findings on which administrative orders rest. Florida v. United States, 282 US 194,

[11]This Court should consider the contrary situation: Suppose the Commission had ordered Phillips to account for refunds without a finding that Phillips' proposed rates were unjust and unreasonable. Would not Phillips have a valid complaint on statutory, if not constitutional, grounds?

215, 75 L ed 291, 304, 51 S Ct 119; United States v. Baltimore & O. R. Co., 293 US 454, 464, 79 L ed 587, 594, 55 S Ct 268; United States v. Chicago, M. St. P. & P. R. Co., 294 US 499, 504, 505, 510, 511, 79 L ed 1023, 1028, 1029, 1031, 1032, 55 S Ct 462; United States v. Carolina Freight Carriers Corp., 315 US 475, 488, 489, 86 L ed 971, 982, 62 S Ct 722. Their absence can only clog the administrative function and add to the delays in rate making. We cannot dispense with them for Congress has provided the standards for judicial review under this Act. Sec. 19 (b). The courts cannot perform the function which Congress assigned to them in absence of adequate findings. Nor are they authorized under Sec. 19 (b) to make findings and substitute them for those of the Commission."

The court below and the Commission deny Petitioners the specific finding they are entitled to by statute. A conclusion that no refunds are required does not follow from a subsidiary finding that costs exceed revenues in a particular period. Simple logic, if nothing else, demands a basic and ultimate finding respecting the lawfulness of the rates at issue before the conclusion is made.

Turning to the Commission's Section 5 (a) investigation, it is important to note that the investigation was intended to be an examination of all of the jurisdictional rates of Phillips for the sole purpose of determining the lawfulness of such rates. The court below says the "Commission abandoned the pending 5 (a) proceeding in which it had been endeavoring to establish rates for the future by methods it now deems inadequate." (App. A, p. 12). The Commission says it terminated the investigation because it does not "think that it is appropriate to set rates for the future on the basis of this record in this hearing * * *." (R. 32656). In its order denying rehearing the Commission offers this reason:

> "[W]e are given discretion as to whether to initiate proceedings * * *. Just as the statute leaves us with discretion as to whether to initiate proceedings we have authority to discontinue proceedings. Regulation under the Natural Gas Act is carried on in the public interest (Section 1(a)), and

there is no obligation to continue these proceedings to the point of making a *definitive finding with respect to Phillips' rates*, where the public interest is not served." (R. 52898) (Emphasis supplied).

The definitive finding the Commission speaks of can only be the statutory requirement of just and reasonable rates.

In *Minneapolis Gas Company v. Federal Power Commission* 294 F.2d 212 (D. C. Cir. 1961), the court below faced the identical issue. There the court said, at page 215:

> "We think the Commission cannot terminate a proceeding after it has actually conducted a hearing to the point of receiving an Examiner's initial decision, without rendering a decision upon the issue presented * * *. [W]e are of the opinion that the Commission, having received all the evidence the parties wish to present, and having before it an Examiner's findings, conclusion and decision, cannot at that point change its mind, wiping out the hearing as though it had never occurred, and in effect decide it will not enter upon a hearing."

The Commission's action in both *Minneapolis Gas* and the instant proceeding resulted in the termination of a proceeding without a decision on the issue presented, which was the justness and reasonableness of rates. Having decided to protect the public interest through the conduct of a proceeding, and having pursued such course through extensive and exhaustive hearings and briefs to the point of initial decision, exceptions, and oral argument, the Commission, in both cases, asserted discretion as to whether to determine the justness and reasonableness of rates. In *Minneapolis Gas* the court found such an assertion unlawful. The majority of the court below refused to make the same judgment in the instant case (App. A, p. 12), while Circuit Judge Fahy, in his dissent, recognized the situations as identical (App. A, p. 20).

An assertion of unlimited discretion to terminate, or abandon, conflicts with Congressional policy. Whenever Congress creates a regulatory agency it uniformly confers broad powers of investi-

gation.[15] These powers are essential parts of the regulatory schemes. *Smith v. Interstate Commerce Commission*, 245 U.S. 33, 46 (1917). For an agency to use any of its powers in a way which conflicts with Congressional policy is unlawful. *Office Employees International Union v. National Labor Relations Board*, 353 U.S. 313, 320 (1957); *Schaffer Transportation Company v. United States*, 355 U.S. 83, 88 (1957).

Certainly it is the intention of Congress that the Commission use Section 5(a) powers to carry out such an investigation as was undertaken in this proceeding. Just as clearly, Congress did not intend that the Commission's power to conduct investigations should be governed by an unlimited discretion to terminate the investigation the moment it reaches "the point of making a definitive finding." (R. 32898).

The law is settled that an agency, such as the Commission, cannot take action without making the finding of fact required by statute. *Mahler v. Eby*, 264 U.S. 32 (1924); *City of Yonkers v. United States*, 320 U.S. 685 (1944). What is particularly serious about the failure to make just and reasonable findings in the instant Section 4(e) and Section 5(a) proceedings is the fact that the termination orders achieve the same result which would have obtained had a finding of just and reasonable been made. By refusing to order refunds the proposed rates became as if just and reasonable rates; by terminating the investigation existing rates remain as if just and reasonable rates.

Finally, Section 8 (b) of the Administrative Procedure Act[16] provides:

> "All decisions * * * shall * * * include a statement of (1) findings and conclusions, as well as reasons or basis therefor, upon all material issues of fact, law, or discretion presented

[15]Examples: Securities Exchange Act (Act of June 6, 1934, c. 404, 48 Stat. 899 (1934), as amended 15 U.S.C. § 780 (1949)); Public Utility Holding Company Act (Act of August 26, 1935, c. 687, 49 Stat. 831 (1935), as amended 15 U.S.C. § 79r (1949)); Federal Power Act (Act of June 10, 1920, c. 285, 49 Stat. 856, 16 U.S.C. § 825 (f) (1935)).

[16]Act of June 11, 1946, c. 324, 60 Stat. 242, 5 U.S.C. § 1007 (b).

on the record; and (2) the appropriate rule, order, sanction, relief, or denial thereof."

The court below and the Commission disregard this requirement.

4. CONSUMER PROTECTION REQUIRES REGULATION, NOT EXPERIMENTATION.

The court below has approved the Commission's promulgation of the Statement of General Policy No. 61-1 (R. 32710-12) whereby the Commission establishes rate levels below which it will not suspend Section 4 (e) increases nor question the rates in new contracts. Such levels will be used until new procedures for the regulation of producers are developed. The court's decision says:

> "[The Commission] has announced guideline rates which it deems to be, on the basis of the internal data in its files on all operators in the several areas, fair rates for the product in those areas. Such rates, thus determined, would seem to be just and reasonable rates for the consumers of the product. And, similarly, they would seem to be just and reasonable charges for the producers to make." (App. A, p. 16).

What the court overlooks is that the rates contained in the Commission's statement were prepared, and can be changed, without notice, hearing, or the taking of evidence. Moreover, the Commission itself does not consider the guideline rates to be necessarily just and reasonable rates:

> "These price levels, as announced by Appendix A attached to this statement, are for the purpose of guidance and initial action by the Commission and their use will not deprive any party of substantive rights or fix the ultimate justness and reasonableness of any rate level." (R. 32712).

Congress intended that just and reasonable rates should be determined in proceedings under Section 4(e) and 5(a). Both provide for hearings.

If the rates contained in the Policy Statement are just and reasonable, as asserted by the court below, then they only prop-

erly may be promulgated after a hearing. Due process demands that the parties to be affected by such rates are entitled to a full and fair hearing. *Morgan v. United States*, 298 U.S. 468 (1936); *Ohio Bell Telephone Company v. Public Utilities Commission of Ohio*, 301 U.S. 292 (1937).

At most, the rates included in the Policy Statement are field, or market, prices for natural gas. In *City of Detroit, Michigan v. Federal Power Commission*, 230 F.2d 810 (D.C. Cir. 1955), cert. denied 352 U.S. 829 (1956), the court below refused to approve a field price as a just and reasonable rate unless the price was tested on a cost of service basis. Therefore, the decision of the court below presents a conflict within the circuit on the issue of field prices.

Section 5 of the Administrative Procedure Act[17] provides that, where a statute calls for an agency hearing, there must be notice and opportunity to be heard. The Commission's own Rules of Practice and Procedure are especially designed to provide for hearings on rate matters. FPC Rules and Regulations, Sec. 1.13-1.26; 18 C.F.R. §§ 1.13-1.26. Accordingly, the Commission's insistence on going its own way, without hearings, in rate matters is unprecedented.

The majority of the court below speaks of the regulation of producers as a "new project." (App. A, p. 12). This Court, when the instant proceeding was first before it, held that Congress intended producer regulation in 1938 when the Natural Gas Act was enacted. Consequently, from June 1938 until this Court's decision in June 1954—a period of sixteen years—there was absolutely no producer regulation. When ordered to regulate, the Commission proceeded with a case by case approach. The Commission's course appeared to be finalized when it said:

> "What [Section 4] does require is the presentation of rate base and cost evidence as a point of departure plus a showing that any additional allowance is no more than is reasonably necessary for the purposes advanced for any increase." *Union Oil Company of California*, 17 FPC 89, 91 (1957).

[17] 60 Stat. 239 (1946); 5 U.S.C. § 1004.

Accordingly, when the instant proceeding commenced, it was assumed by all parties that the Commission would adhere to this course.

Paradoxically, the Commission pursued such course yet refused to follow it to an end. The Commission terminated the rate proceedings and says, in effect, that future producer rate regulation must await the outcome of its area, or commodity, rate proceedings. As a result, the Commission has returned to the same course it followed from 1938 through 1954. The Commission, instead of accepting the Congressional mandate of regulation, adopts a policy of experimentation. The court below recognized that the interim period while new procedures are being formulated may last from "four to fourteen years." (App. A, p. 13). Even this assumes that area rates will be finally approved. In the meantime, there will not be the regulation envisioned by Congress, by this Court, and at one time by the Commission itself.

The question narrows down to one of *experimentation or regulation*. Clearly Congress intended regulation.

Consumer needs are present, not future. Natural gas is a commodity which is being consumed daily and presently by the industry of America and by its people. The clear intent of the Congress in providing for protection against exploitation was present protection, not a deferral to some future providence.

Six years after being ordered to commence regulation of producers, the Commission, upon the threshold of a practical, workable, and legally sound manner of doing so, turns its back upon the process and sets forth into new, uncharted fields and courses, seeking answers unknown presently even unto itself. The answers it seeks, judging by its Policy Statement, are fraught with practical and constitutional difficulties. Most importantly, they apparently require years of searching, exploration, and experimentation which, when added to the time already involved in its efforts, may arrive at a dubious method of regulation fourteen years from the present. Thus consumer interests are in attendance, awaiting answers which may arrive in the year 1974, if they do arrive.

B. The Decision of the Court Below and the Opinion of the Commission Fail to Provide Lawful Regulation of Producers.

1. THE COST OF SERVICE METHOD MUST BE USED UNTIL REPLACED BY ANOTHER LAWFUL METHOD.

The court below agrees with the Commission "beyond any doubt, that the traditional original cost, prudent investment rate base method of regulating utilities is not a sensible, or even workable method of fixing rates of independent producers of natural gas." (App. A, p. 5). Actually, there is much doubt about this statement. As pointed out in the dissent:

> "The Commission has actually found Phillips' cost of service on the basis of the record made and has arrived on the same record at a proper rate of return, stating 'this is clearly a *lawful* way to determine rates for Phillips as illustrated by the *City of Detroit* case, . . . and under the present record is the *only possible method* . . . .' *In this manner the Commission has come so close to doing what it says it should not do as to demonstrate that it is able to do what it has failed to do.*" (App. A, pp. 20-21). (Emphasis supplied).

Cost of service analysis is the conventional approach to rate determination. Referring to rate making under the Natural Gas Act, this Court observed in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 616 (1944):

> "The Committee Report stated that the Act provided 'for regulation along recognized and more or less standardized lines' and that there was 'nothing novel in its provisions.'"

In *City of Detroit, Michigan v. Federal Power Commission*, 230 F. 2d 810, 818 (D.C. Cir. 1955), cert. denied 352 U.S. 829 (1926), the court below, referring to cost of service, states:

> "It has been repeatedly used by the Commission, and repeatedly approved by the courts, as a means of arriving at lawful—'just and reasonable'—rates under the Act. *Unless it is continued to be used at least as a point of departure*, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning." (Emphasis supplied).

The courts have with consistency fastened upon a showing as to cost. Beginning with the *Hope* case, down to the *City of Detroit* case, and as recently as *Bel Oil Corporation v. Federal Power Commission*, 255 F. 2d 548 (5th Cir. 1958), cert. denied 358 U.S. 804 (1958), *Forest Oil Corporation v. Federal Power Commission*, 263 F. 2d 622 (5th Cir. 1959), and *Episcopal Theological Seminary v. Federal Power Commission*, 269 F. 2d 228 (D.C. Cir. 1959), cert. denied 361 U.S. 895 (1959), the courts have refused to discard the cost test.

Far from being not "sensible" and not "workable", the Commission itself, in a recent opinion, has relied on cost of service to reach a result in a certificate proceeding. *Continental Oil Company*, FPC Opinion No. 351, January 22, 1962.

The majority of the court below lists several grounds for rejecting cost of service in producer rate cases. The court asserts that such method "penalize[s] the efficient or fortunate and reward[s] the inefficient or unfortunate." (App. A, p. 5). Furthermore, " 'extremely difficult' problems of allocating costs are involved." (App. A, p. 5). Finally, there is the problem of the "administrative burden of full rate cases for each of thousands of independent producers." (App. A, p. 6). These grounds are without merit.

First, the court does not say how the so-called efficient, fortunate producer is penalized, what harm is done to him, how he suffers in contrast to a less efficient, unfortunate producer. The court's statement assumes that there is some advantage to be gained by being inefficient and having bad luck. Under cost of service regulation both receive a fair return on investment and one is placed in no better a position than the other. Actually, in our free enterprise system, other business factors, such as quality of service or competence of management, work to penalize the inept and unlucky and to favor the efficient and fortunate.

Second, the examiner's decision provides a sensible and workable formula for the allocation of costs between gas and oil. Neither the Court nor the Commission questions such formula.

Third, the alleged administrative burden of producer rate cases cannot be met by a decision to do nothing. The Commission should apply self-help and expedite its hearings and decisions. The history of producer regulation is one of delay and indecision. Certainly the mandate of Section 4(e) to "decide the same as speedily as possible" is not being followed. The blame properly cannot be placed on the cost of service method.

Since the court below has treated the instant case as one dealing with the rates of natural gas producers generally, it is important that this Court review the rejection of cost of service. By such rejection the Commission has left itself with no known, workable, and approved system to regulate while it experiments with new procedures.

2. SPIRAL ESCALATION CLAUSE INCREASES ARE UNLAWFUL IN A REGULATORY SETTING.

Spiral escalation clauses can best be explained by a description of their operation. These clauses permit increases in the contract price received by a producer from a pipeline company when there is an increase in a price index followed by an increase in the resale rates of the pipeline company. When both these conditions are met, the contract price is increased in proportion to the increase in the resale rates.[18]

In the instant proceeding, Dockets Nos. G-11217, G-10883 and G-10793 are rate increase filings based on the activation, or "triggering", of spiral escalation clauses. The Commission left open Docket Nos. G-11217 and G-10883 only for the resolution of the extent of the increase, and for "no other matter." (R. 32696). They were left open because the resale rates of the pipeline companies had not yet been finally determined. In the third docket, No. G-10793, the rate increase was allowed to become effective. Consequently, in each instance, the Commis-

[18]The Phillips El Paso contracts contain typical spiral escalation clauses. These agreements provide that when the commodity index increases more than a prescribed number of points and a general increase in El Paso's rates is put in effect, then Phillips' rates will be increased in proportion to the increase in El Paso's rates. (R. 31642-43).

sion gives legal effect to the clauses. Yet the court below refuses to review the issue. (App. A, p. 18).

An analysis of the whole scheme of natural gas regulation makes it clear that the elimination of spiral escalation clauses from purchase contracts is essential to the regulation of an industry affected with a public interest. Such clauses permit price increases based on fortuitous events and not regulatory requirements. They allow natural gas prices to soar on the basis of automatic and arbitrary adjustments which have no relationship to increases, if any, in Phillips' costs.

The Commission made it clear that one of the major issues in the proceeding was whether spiral escalation clauses are "so ambiguous in language and so inflationary in effect as to contravene the public interest and conflict with the regulatory powers of the commission, or are otherwise unlawful." (R. 31003). In its opinion the Commission says:

> "While we do not approve of such clauses in principle, there is not sufficient basis on this record to hold them void as a matter of law." (R. 32694).

The court below recognizes the unlawful character of these devices, but errs in holding the question is not ripe for review. The court says:

> "Wisconsin and California contend that the Commission should now declare these escalator clauses to be illegal and void as against public policy. As a matter of fact the Commission has declared these clauses to be against the public interest and that they should be held inoperative. But, the Commission says, in so far as these cases of Phillips are concerned, action of the sort demanded by Wisconsin and California is premature. Action on these clauses, it says, should await action on the pending cases which in orderly processes present the problem for decision. We agree with the Commission." (App. A, p. 18).

The court neglects to note that the Commission overlooks the spiral escalation increase in Docket No. G-10795, unaffected by pending pipeline company litigation, which was approved. The approval in this instance, at least, presents the issue for review.

No record, either in this proceeding or any other proceeding, can justify the presence of these clauses in natural gas contracts. Moreover, the court below and the Commission may not perpetuate the existence of a device which is unlawful.

C. The Decision of the Court Below and the Opinion of the Commission Overlook the National Importance and Significance of This Proceeding.

1. THE IMPORTANCE OF NATURAL GAS REGULATION TO CALIFORNIA CONSUMERS.

California commenced importing natural gas from out-of-state sources in 1947. In 1960 it purchased 804,600,000,000 cu. ft. of gas from El Paso Natural Gas Company (El Paso) at a cost of $252,000,000. The most recent figures show that during the period from November 1960 through October 1961 California purchased from El Paso 774,000,000,000 cu. ft., paying $257,000,000.[19]

The California Public Utilities Commission conservatively estimates that by 1970 California will be importing 1,825,000,000,000 cu. ft. annually and will be paying in excess of $700,000,000.

California's interest in this proceeding stems from its unique dependence upon natural gas as a fuel. Since California does not possess coal deposits sufficient for its energy requirements, it is compelled to rely upon natural gas. Ninety percent of all homes in California are heated by natural gas, and California industry relies almost exclusively upon natural gas as a fuel. California now depends upon El Paso for approximately three-quarters of its needs.

El Paso obtains the gas it sells from various sources, chief among which is Phillips. El Paso purchased 212,946,306,000 cu. ft. from Phillips in 1960. This cost El Paso $31,347,200.[20] El

[19]These statistics are compiled from monthly reports filed with the California Public Utilities Commission by California natural gas public utility distributing companies.

[20]Annual Report of El Paso Natural Gas Company to Federal Power Commission for Year Ending December 31, 1960, FPC Form 2, Gas Purchase Account, pp. 89-90.

Paso's costs are passed on, under the cost of service method, to the California distributing utilities so as to assure El Paso a fair return above its costs. The California utilities, in turn, pass them on to the California consumers.

California consumers, then, have a substantial interest in the regulation of producers such as Phillips. This interest serves to emphasize the importance, and the impact, of the majority's decision to uphold the Commission. This Court should review that decision in the light of this interest for involved here are the regulatory principles which assertedly are to govern not only Phillips' rates, but also the rates of all producers.

2. THE NATIONAL IMPORTANCE AND SIGNIFICANCE OF PRODUCER REGULATION.

The fact that the costs of purchased gas are eventually paid by the consumers points out the national importance and significance of effective regulation of the price of natural gas at its production stage. Producers, such as Phillips, sell gas to pipeline companies, such as El Paso, at wellheads, at field gathering points, or at outlets of processing plants. The prices fixed at these points of sale are crucial in the determination of the prices set by the pipeline companies to the distributing companies, and the prices charged by the latter to the ultimate consumers. Absent producer regulation, the Natural Gas Act would be only a makeshift barricade against a surging river without any attempt to control the river itself. With the decision of the court below and the opinion of the Commission, regulation of the natural gas industry at this focal point of its activity is, in effect, suspended.

During this indefinite period of suspension the nation can expect further decline in the ratio of natural gas reserves at end of year to net production. In 1947 it was estimated that there were 29.5 years of reserves in the United States; in 1960 it was determined that there remained only 20.2 years of reserves.[21]

[21]Source: American Gas Association, Historical Statistics of the Natural Gas Industry.

Moreover, the ratio of annual gross additions to natural gas reserves to net production is also declining. If consumers are to wait as long as fourteen years until a kind of regulation called for by the Natural Gas Act and the courts is resumed, if it is resumed, then there may well be no gas, or very little gas, left to regulate.

Conceding, however, that the life index of the gas reserves may be approximately forty years, as optimistic segments of the industry assert, the nation's consumers are then confronted with the chilling fact that their guardian against exploitation has left them without protection since 1948—a period of twelve years in the life of the gas reserves, or when coupled with an additional fourteen years of experimentation, a total of twenty-six years absent effective regulation.

Time is crucial in this proceeding. Accordingly, the proceeding may best be disposed of, in the national interest, by following the position of Circuit Judge Fahy in his dissent:

> "These cases need not be treated as if they were ventures initiated in search of an ideal method of regulating the rates of independent gas producers. Having in mind the history of these proceedings, and the primary congressional purpose of consumer protection, it seems to me that decisions on the present record, supplemented as may be found to be reasonably necessary, would be far more likely to approximate fulfillment of the purposes of the Act than are the termination order and the resulting situation." (App. A, p. 20).

During this period of suspension, rate increase may be piled upon rate increase without any hearings as to their justness and reasonableness. In an inflationary economy, a time lag in the adjudication of the lawfulness of successively increased rates will work to the harm of the consumer. It will be difficult, if not impossible, for the Commission to adjudicate the reasonableness of rates which have long since been overcome by inflation.

The judicial mandate and the dictates of the Natural Gas Act could be openly defied, but without success, if the Commission were to announce its outright refusal to regulate the production

of natural gas. Petitioners ask whether or not interminable administrative proceedings—apparently seeking an ideal and perfect method of doing things and always at great length and consuming long periods of time—are not presently or, at least, will not soon be tantamount to failure to regulate. Certainly it can be said that if this grand experiment, seeking that best of all possible regulatory worlds, continues for another fourteen years, America's needs will be less than effectively protected, if at all.

CONCLUSION

Petitioners respectfully request the opportunity to present these questions to the Court more fully. They are important questions of public law. Their resolution will have far-reaching effect.

They are questions affecting millions of citizens and involving billions of dollars.

Petitioners respectfully submit that this petition for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit should be granted.

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(Appendices follow)

Appendix A

United States Court of Appeals
For the District of Columbia Circuit

No. 16175

STATE OF WISCONSIN and PUBLIC SERVICE COMMISSION OF WISCONSIN, PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT
PHILLIPS PETROLEUM COMPANY, INTERVENOR

No. 16177

LONG ISLAND LIGHTING COMPANY, et al., PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT
PHILLIPS PETROLEUM COMPANY,
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, INTERVENORS

No. 16180

PEOPLE OF THE STATE OF CALIFORNIA and PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT
PHILLIPS PETROLEUM COMPANY, INTERVENOR

On Petitions for Review of Order of the Federal Power Commission

Decided November 30, 1961

Mr. William E. Torkelson for petitioners in No. 16175.

Mr. J. David Mann, Jr., with whom *Messrs. John E. Holtzinger, Jr.*, *William W. Ross*, and *David K. Kadane* were on the brief, for petitioners in No. 16177.

Mr. William M. Bennett for petitioners in No. 16180.

Mr. Arthur H. Fribourg, Attorney, Federal Power Commission, with whom *Mr. John C. Mason*, General Counsel, Federal Power Commission, at the time the brief was filed, and now Deputy General Counsel, and *Mr. Howard E. Wahrenbrock*, Solicitor, Federal Power Commission, were on the brief, for respondent.

Mr. Kenneth Heady, of the bar of the Supreme Court of Oklahoma, *pro hac vice*, by special leave of court, with whom *Messrs. Charles E. McGee* and *Lambert McAllister* were on the brief, for intervenor Phillips Petroleum Company.

Messrs. Kent H. Brown and *George H. Kenny* and *Mrs. Barbara M. Suchow* were on the brief for intervenor Public Service Commission of the State of New York in No. 16177.

Before PRETTYMAN, FAHY and DANAHER, *Circuit Judges*.

PRETTYMAN, *Circuit Judge:* Some controversies concern major problems of general application. Others concern only a limited set of circumstances. The case at bar is of the former variety. The questions are posed by complicated procedural difficulties. They concern the procedures of the Federal Power Commission in dealing with the rates of natural gas producers.

The Phillips Petroleum Company is a producer of natural gas. It procures gas from several widely separated and widely differing areas. It explores for, develops, produces, purchases, gathers and processes gas and oil. It sells gas to pipeline companies[1] under contracts negotiated by it and these customers. The

[1] It also sells oil, products condensed from gas, and other petroleum products and chemicals. It sells natural gas in several conditions. It sells to customers other than pipelines as well.

contracts differ in such terms as delivery conditions, water content, hydrocarbon content, place of delivery, pressure, and price.

Two sections of the Natural Gas Act[2] are involved. One (Section 4(e)) provides in essence, as to sales subjected to regulation by the Commission, that when a rate or an increased rate is filed the Commission may suspend it for five months, meantime setting it for hearing. When such a rate goes into effect after the period of suspension (the Commission not having concluded its consideration), the funds derived from the newly-filed rates may be impounded and, in so far as the Commission fails to approve them, may be refunded. The burden of proving in such a proceeding that an increased rate is "just and reasonable" rests upon the company. The other section of the statute (5(a)) provides in essence that, either upon a complaint or upon its own motion the Commission may inquire into an existing rate. If that rate be found unlawful the Commission must determine what shall thereafter be deemed a just and reasonable rate. Its decision becomes effective from its date. No refund is involved.

In October, 1948, the Commission instituted a proceeding under Section 5(a), the latter of the above sections, concerning Phillips's rates. In that proceeding it decided it had no jurisdiction over the rates of producers of natural gas. This court reversed the Commission,[3] and the Supreme Court affirmed our decision.[4] The Commission reinstated its 5(a) proceeding.

Meantime and thereafter Phillips filed increased rates in respect to many of its contracts. The Commission suspended them and set them for hearing, under Section 4(e) of the statute, the first of the two sections above discussed. Many purchasers, many contracts, many rate schedules, and many filings were involved. Thus many 4(e) proceedings, under different docket numbers, were instituted. As time went on, Phillips filed further proposed

[2]52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-717w.

[3]State of Wisconsin v. Federal Power Comm'n, 92 U.S. App. D.C. 284, 205 F.2d 706 (1953).

[4]Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

increases in some of these same rates. In such event the earlier proposed rate would, if approved, cover a limited period, *i.e.*, until the succeeding increase in that same contract rate was filed. A period thus limited is called a "locked-in period" in the jargon of the industry. These later increases were also suspended by the Commission. Thus many proceedings under Section 4(e) involving rates of Phillips became pending.

The Commission consolidated the 5(a) proceeding and twelve of the 4(e) proceedings for hearing. These twelve 4(e) proceedings involved an aggregate of about five and a half million dollars in proposed increased rates. The proposed rates ranged from 5½ cents per Mcf to 13-½ cents per Mcf. The proceeding was long, detailed, and resulted in a voluminous record of testimony and exhibits. The Examiner rendered a long (174 printed pages), careful and complete initial decision. He approached the problem from the standpoint of cost-of-service[5] and rate base. Many perplexing problems were presented. He examined them all and decided them. Among them were different approaches to cost-of-service, the allocation of production costs, the allocation of exploration costs, the problem of natural gas liquids, the rate base, adjustment to the test year, the computation of the income tax component, the proper rate of return, working capital, allocations between jurisdictional and non-jurisdictional sales, field prices, a discussion of system-wide as compared with area rates. Upon all these the Examiner made detailed findings and conclusions, displaying commendable patience and grasp of the subject matter. He adopted a system-wide approach and found that Phillips's total jurisdictional cost of service, properly computed, was $57,280,218 for the test year,[6] or an average unit cost of 11.662 cents per Mcf. He recommended that Phillips be ordered to calculate a maximum rate for gas with certain described qualities at such level that, when applied to the sales volume

[5]Cost-of-service in this context includes not only operating expenses, taxes, exploration allowances, and gas purchases but also a fair return on the rate base.

[6]Compared with 92.3 million dollars claimed by Phillips.

for all jurisdictional contracts, adjusted for approved delivery condition differentials, would produce revenues roughly equal to the system-wide cost of service. He recommended that Phillips be ordered to file, with full explanations, a list of rates so calculated. These calculated rates would be subject to approval by the Commission. He recommended that the rates thus calculated and approved be applied in both the 4(e) and the 5(a) proceedings, *i.e.*, to both suspended and future rates.

The Commission reversed the Examiner. Its decision and findings were also extended and exhaustive (82 printed pages, plus exhibits). One Commissioner dissented in respect to the computation of the cost of service; otherwise he concurred. Basically, the Commission concluded "beyond any doubt, that the traditional original cost, prudent investment rate based method of regulating utilities is not a sensible, or even a workable method of fixing the rates of independent producers of natural gas." It pointed out critical differences between pipeline operations and producer operations, quoting from opinions by Mr. Justice Harlan and Mr. Justice Jackson, and saying that in regulating producers it is faced with problems entirely different from those of an ordinary public utility. It pointed out that simply to allow producers a return on investment would penalize the efficient or fortunate and reward the inefficient or unfortunate. Only where a producer purchases a fully developed acreage at a fair price does his investment have a real relationship to his return. The producer who first takes the risk in an area and proves it productive pays less for his rights than those who come later. But he must invest his funds before he knows whether he will have anything to sell or not. Mr. Justice Jackson once wrote that "there is little more relation between the investment and the result than in a game of poker."

The Commission pointed out that a producer of natural gas also produces oil, the price of which is unregulated, makes sales (intrastate, etc.) not subject to Commission jurisdiction, and sells products also excluded. Thus "extremely difficult" problems of allocating costs are involved. It commented that none of the ex-

perts proposed allocations acceptable to other experts. "Ridiculous results will be reached among the great number of producers and owners of interests if costs should be the only basis for regulation." It referred to the fact that much of Phillips's gas is purchased from thousands of independent producers whose rates are under percentage-type casinghead contracts, dependent on Phillips's rates. The interests of the many royalty owners must also be considered. Another problem is the administrative burden of full cost rate cases for each of thousands of independent producers. Adherence to cost rate-base methods results in necessity for a full-scale company-wide cost study to determine the proper price in any one contract. At the time of this Commission decision 3372 independent producers had rates on file. Five hundred seventy producers were involved in 3278 proposed rate increases under suspension and awaiting hearing. Of eleven rate increase cases in which full hearings had been had and decisions rendered, ten showed the increases justified. A special problem prevented decision in the other. In the three 5(a) cases theretofore completed, the producers' prices were found justified. Rigid adherence to the rate-base method would in many cases price the producers' gas out of the market. "From the foregoing, it follows that effective regulation of the price of natural gas must be on some more manageable plan than the rate base method. Thus it it clear that the better method would be to establish fair prices for the gas itself and not for each individual producer."

Simultaneously with the foregoing opinion the Commission promulgated a "policy statement" setting forth rate guidance schedules for various producing areas. These schedules consisted of two rates prescribed for each of twenty-three producing areas throughout the country (except for two areas, for which only one rate was given). One rate was for initial service, *i.e.*, new contracts, in the area. The other was for increases in rates, *i.e.*, proposals for increases in existing contracts, in the area. For example, in the first area listed (Texas District No. 1) an initial service rate of 15.0 cents per Mcf was given and an increased

rate level of 14.0 cents per Mcf. The Commission described its preparation of these schedules thus:

> "In arriving at the price levels for the various areas set forth in the appendix to this statement, we have considered all of the relevant facts available to us. Such consideration included cost information from all decided and pending cases, existing and historical price structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas. Of necessity, we have not set forth the adjustments to these prices which must be made to take into account every possible provision of every contract which may affect the actual price, such as Btu adjustments, conditions of delivery, etc. The relevance of such adjustments to the basic contract price and the appropriate established price standard must be considered as each filing is made."

The proposed use of this list was described by the Commission as follows:

> "* * * These standards will serve as a guide to us and to interested parties in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended.
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> "These price levels, as announced by Appendix A attached to this statement, are for the purpose of guidance and initial action by the Commission and their use will not deprive any party of substantive rights or fix the ultimate justness and reasonableness of any rate level."[7]

In its opinion the Commission said further: "This schedule of prices is only for guidance and does not constitute any determination of just and reasonable rates and will not foreclose any person from justifying a particular rate in any area." The schedule is of maximum acceptable rates for gas from a given area.

[7]Statement of General Policy No. 61-1, Sept. 28, 1960, 25 Fed. Reg. 9578 (Oct. 5, 1960).

as opposed to rates established for each rate filing by each producer after a full cost-rate base consideration of each rate so filed.

The Commission disposed of the consolidated cases before it in three parts. The first part consisted of the superseded rates of the prior periods ("locked-in" periods). The second consisted of the presently current rates and those to be in effect during the interim period from now until the newly proposed area-rate system is completely designed and put into effect. The third part consisted of rates for the future after the completion and inauguration of the area-rate system.

Before we consider these several dispositions in detail we must understand the problem with which the Commission was dealing. The rates proposed to be increased in these 4(e) proceedings are not the rates of utilities in the traditional sense, such as pipelines. The rates here involved are the charges made by companies which buy or produce a product, process it to suit the requirements of a customer, and sell it to that customer under a contract. The product is procured from many different places, from Texas to West Virginia, from Louisiana to Wyoming. In its raw state it is of many different contents. Different customers require different terms as to the physical qualities of the delivered article, points and terms of delivery, and other factors. Hundreds of producers, hundreds of contracts, and thousands of rate filings are involved.

When we use the terms "cost of service" or "rate base" in this context, we must be careful of the meaning we intend. There is a system-wide cost of service. This would be, as the words indicate, a computation for the entire Phillips system. But even so it would not be a computation for all Phillips operations, because the Company has many operations, such as those in petrochemical fields, and sales of all sorts of petroleum products, and many sales not subject to federal regulation under present statutes. In fact the Company's gross income from sales of natural gas in 1955 was less than six per cent of its total gross income. So even a system-wide computation of cost of service for sales of natural gas subject to Commission regulation requires monu-

mental allocations of many costs, such as exploration costs, taxes, administration expenses, purchases, extraction costs, sales of residue gas and liquids, and so on. Nevertheless such a computation was made. The Examiner and also the Commission determined and used a system-wide cost of service. As found by the Commission the system-wide cost of service for Phillips's sales of natural gas subject to Commission jurisdiction in the test year 1954 was $55,548,094, or 11.309 cents per Mcf. But even the figure thus carefully computed was subject to adjustment for purchased gas costs, gathering taxes, and royalties. The same observations apply to the rate base on a system-wide basis. One was determined by the Commission.

Then, theoretically at least, there is a cost of service for each contract, if not for each rate, and so for each 1(c) proceeding. But nobody, so far as we are advised, contends that any such computations could be made with any meaningful results by any known method. The results of any such effort would be pure guesswork, involving a vast multiplication of the arbitrary allocations which would have to be made.

The Examiner did not attempt to make any cost-of-service determination on individual contract, rate, or case basis. He determined a system-wide cost of service, which gave him a nation-wide average unit cost of 11.662 cents per Mcf. He then proposed that "[b]ased on the system-wide cost of service herein approved, as set forth in Appendix Table 12 hereof, Phillips shall calculate the maximum rate for 1,000-pound, sweet, dehydrated, and gathered gas at such level that its application to the sales volumes delivered in 1954 under each and every one of the 1954 jurisdictional contracts, as adjusted for the approved delivery condition rate differentials, will produce total revenues roughly equal to such system-wide cost of service." He proposed further that "Phillips shall file with the Commission a statement of such 'maximum rate,' including a clear and detailed explanation as to the manner in which it was calculated, together with a list of *calculated rates* for all of its jurisdictional rate schedules then in effect." The Commission, as we have said, reversed the Examiner, treating the case, in effect, in three parts.

1. As to the first part of the problem, the 4(e) proceedings, dealing with suspended proposals now superseded, the Commission made system-wide conclusions as to jurisdictional sales and applied them to these cases. It found $45,568,291 of revenues against $55,548,054* cost of service. This showed a system-wide deficit of some $9,000,000 on jurisdictional sales of natural gas. The Commission noted that no evidence had been presented to show that the different rates in these different (4(e)) proceedings were unduly discriminatory or preferential, which notation, translated, means that any adjustment in these rates should be correspondingly proportionate in respect to each and all. The Commission applied the result of its system-wide calculations to each and all of the 4(e) proceedings and concluded that no refunds were due. Having thus ordered, it concluded ("terminated") the proceedings.

The Commission made no determination of the cost of service of each of these contract rates separately; it had no evidence before it upon which it could make such determinations, and it was of opinion that such computations would be unworkable and foolish under the circumstances.

In these 4(e) cases, as we have pointed out, the Commission was dealing with a locked-in period. The revenues derived from the rates at issue had been impounded. The only question of substance in respect to that period was whether refunds should be made. The Commission decided that question, flatly and directly. No other question remained in those cases for decision. They presented no questions as to rates to be charged. Each presented the question whether a refund was due that customer for that past period and, if so, how much. Having made three determinations—(1) that there was a deficit of some $9,000,000 a year in revenues against cost of service, (2) that the increases involved totaled about five and a half million dollars and so, if allowed in full, would not wipe out the operating deficit, and (3) that any adjustments should be proportionate to all contract rates—

*Modified to $54,525,315 after rehearing.

it concluded that no refund was due on any contract, &c., in any 4(e) proceeding. Section 4(e) pertinently says that the Commission may 'order a refund of the portion of such increased rates or charges by its decision found not justified.' We cannot say that a deficit justifies or requires a refund or that the Commission was unlawfully arbitrary in reaching that result from the premises.

We think the Commission's course was reasonable and tenable. Surely, if only a single rate had been involved, and enough evidence were introduced to justify, under testing, a conclusion that the company was operating at a deficit under that rate, it would not be necessary that evidence be taken to establish the precise penny amount of the deficit in order to support a reasonable inference by the Commission that no refund was indicated. Of course, in the matter at bar a number of rates in separate cases were involved, but the principle of procedure and the scope of permissible inferences from basic facts are much the same as in the suggested illustration. We think the facts support the conclusion.

It is argued that the Commission did not declare the rates under consideration to be just and reasonable or the contrary; that, instead, it 'terminated' the proceeding. The contention is that the Commission made no decision. We think the point is not well taken. The Commission did make a clear decision, after elaborate findings, upon the one substantive issue before it. It did say it 'terminated' the proceedings, but it terminated them after decision, the basic and dispositive issue, and it entered an order on that decision. Its 'termination' was much like that of a judge after he has rendered findings, conclusion and judgment.

Whether the Commission should have preceded its ultimate conclusion of no-refund with an intermediate conclusion of justness and reasonableness in the rates at issue, and whether it properly added the termination order to its decisive finding, seem to us to be immaterial queries. The important feature is that the Commission reached and decided the critical substantial issue, rationally and upon detailed findings of basic facts upon an ample record.

This is not a *Minneapolis Gas*[9] situation, in which the Commission did nothing but simply terminated the proceeding without passing upon any of the disputed issues before it.

2. The case yields to clearer treatment if we next consider the part of the Commission's treatment which is last in chronological order, that is, the determination of rates for the future. As to these rates the Commission embarked upon the formulation of a new method of fixing just and reasonable rates for producers. It inaugurated hearings for that purpose. We think we need not explore the possibilities of success in that venture, or stop here to describe the projected scheme previously outlined in this opinion. In general it is referred to as an area-price method; it aims to establish proper prices for the gas rather than for the seller thereof. The Congress has confided the regulation of the natural gas industry to the Commission, not to the courts. The Supreme Court has said several times that the Commission is not bound to any one method or to known methods. The regulation of gas producers is a new project. Obviously, as is cogently pointed out in this record, it presents new and complex facts and problems. It would be foolish for the courts to hold that the Commission is bound to apply to these new conditions the methods and measurements designed and used for other and different regulatory purposes. We think it is clear that the Commission had ample authority to embark upon an effort to design suitable new standards for use in the regulation of producers when it found that the tools at hand were not suited to this purpose. The Commission abandoned the pending 5(a) proceeding in which it had been endeavoring to establish rates for the future by methods it now deems inadequate. We see no reason why it should not have done so.

3. The difficult part of the case before us concerns the second, or middle, part of the Commission's disposition. This involves the rates for the period from 1959 until the new system—or a

[9]Minneapolis Gas Company v. Federal Power Commission, U.S. App. D.C. , 294 F.2d 212 (D.C.Cir. 1961).

new system is designed and established. This period will be long, estimates running from four to fourteen years. The rates during this period may, theoretically, be (1) rates in effect without increases having been proposed after January 1, 1959, (2) rates proposed to be increased since that date and suspended under Section 4(e), (3) rates for which increases may be proposed after the present time, (4) initial rates, *i.e.*, rates under new contracts made after January 1, 1959.

To meet the need for interim regulation the Commission took several steps. It published the policy statement which we have described. That announcement contained several components. First, the Commission said that in determining its own *sua sponte* action in respect to rates (*i.e.*, suspending proposed increases or inaugurating inquiries into existing rates) it would be guided by the guide rates. Second, it said that persons attacking rates (*i.e.*, customers and consumers) would be required to present evidence as to the industry generally in the area concerned, as well as the traditional evidence relating to the individual producer involved. Third, it said that "[a]s experience and changing factors may indicate," it would change the areas designated and likewise change the guide prices. Fifth, it said it will use its guide rates in disposing of 4(e) (*i.e.*, suspended proposed increases) proceedings arising upon increases proposed since January 1, 1959.

Refraining from exploring the various arguments, and argumentative trails, pointed out to us by the parties, we come directly to the crux of this problem. Has the Commission power under the Natural Gas Act to do what it did? Can it adopt upon the basis of its own expertise and its files, without a record made in the open in respect to the specific subject matter in issue, and without hearing, a set of guide lines by which it will be controlled in its regulatory functions during an interim period while it is attempting to perfect a suitable system for permanent regulation? We think it can.

In the first place, and throughout, we must remember that the Congress has power to direct the regulation of interstate commerce, and it has placed that regulatory power over natural gas

in the Power Commission. We must remember that the problem at bar concerns a regulatory power. We are not considering adjudicatory, or quasi-judicial, power. It has long since been established that rate-making is a legislative function, and it is so defined in the Administrative Procedure Act.

Regulation poses many difficult problems. New regulation poses acutely difficult problems. Solutions often-times develop slowly. Many illustrations of that fact could be called to mind.

What power has the Commission in respect to interim regulation while the permanent structure is being designed and erected? Must it use means and methods long established for use in respect to other and different regulatory necessities? Or may it design from its own judgment and accumulated data a new method designed for the new problem? The differences between a public utility, such as a pipeline rendering a service by means of a fixed plant and operation, and a producer, who discovers or buys a product where, when and under such terms as he may, and sells that product under contracts negotiated on the open market, are too evident to justify elaboration. Whether the method thus designed and put into use by the Commission is good or bad is no part of our problem. Our inquiry is whether it was within the orbit of statutory authority and whether it was within constitutional limitations. We turn to those questions.

The Natural Gas Act is broad in its bestowal of power. It declares that all rates demanded by a company in connection with the sale of gas in interstate commerce for resale shall be just and reasonable. Section 4(a). A gas company files with the Commission schedules of its rates. Section 4(c). If a company proposes to increase a rate, it must file a new schedule. The Commission may then enter upon a hearing concerning the "lawfulness" of the proposed rate. Section 4(e). If the Commission, on its own motion or upon complaint, finds a rate unjust, unreasonable, unduly discriminatory or preferential, the Commission "shall" determine the just and reasonable rate. Section 5(a). Of course, constitutional restrictions apply; rates fixed by governmental authority cannot be confiscatory; all procedures must be

by due process, that term conveying meanings differing according to the basic nature of the proceeding but always including that which is fair and decent according to the standards of our social order and time.

The statute contains no definition of a "just and reasonable" rate. It is established by tradition and by many court decisions that for a public utility rendering service by use of fixed equipment, a just and reasonable rate is one which returns a fair profit upon the investment, or which supplies the utility with adequate revenues to command needed funds upon an economically reasonable basis. But what of a fair price for a commodity bought and sold by a merchandiser? Almost the whole of the economics of merchandizing differs from the economics of public utility service. Are the just and reasonable prices of such a merchandiser limited to fair returns on his own investment and prices paid by him (and if so, what investment and what prices), or are those prices reasonably measured by the fair prices for the product as measured by the open competitive market for the product, evaluated by Commission expertise and data on the whole of the market operation? Either criterion is a method of regulation. It seems to us that the choice must lie with the Commission.

Let us emphasize that we do not have before us at this time the question whether any rate set by the Commission as a guide rate falls within the area of reasonable computation. That question is emphatically left open by the Commission, and by us, for consideration when some one or more of the selected guide rates is attacked by a producer, a customer, or a consumer. The problem here at this time is merely whether the Commission may embark upon this method of regulation. Since it is the Commission's judgment that this method is best suited for the regulation of these prices, for the determination of their justness and reasonableness, we find in the statute nothing to deny a trial of the method.

Of course, conceivably, justness and reasonableness from the standpoint of the consumer might be defined as limiting the

vendor's return to a fair amount on his investment, and his price accordingly. But, if the government agency charged with the responsibility in the public interest finds, after elaborate accumulation of data, that such a measurement is unworkable, may not a fair price for the product reflected on the open market, after scrutiny and adjustment by the government agency concerning the factors which produced that price, be just and reasonable for the consumer? Of course the agency would be required to be alert for artificial impulses in such a fair area price, and the avenues of attack by consumers would have to be kept open without obstruction; but, if the latter is avowed, how could we assume in advance that the agency would not protect the consumer as it is charged by the Congress to do? The Commission is not here proposing to accept a field price, or any other price as is. It has announced guideline rates which it deems to be, on the basis of the internal data in its files on all the operators in the several areas, fair rates for the product in those areas. Such rates, thus determined, would seem to be just and reasonable rates for the consumers of the product. And, similarly, they would seem to be just and reasonable charges for the producers to make.

As to the constitutional question of confiscation, it would seem to us that the question should await the proof presented by a producer in respect to a particular rate in a particular area.

Thus we come to conclude that the interim method of regulation proposed by the Commission does not appear at this point in the process to be violative of either statutory or constitutional limitations.

It is urged upon us that the Commission has abandoned regulation of these rates for this interim period. We do not agree with that view. It has certainly changed the method of regulation, or, more precisely, the standards by which it will apply its regulatory power. It has abandoned case-by-case, contract-by-contract measurements on a cost-of-service rate-base basis. It has installed an area fair price measurement for the prices of the product to be sold. In so doing it has abandoned a method it finds to be unworkable and foolish in favor of a method it deems to be

workable and just and reasonable. If that be so, instead of abandoning regulation it is making regulation effective. The choice it faced, at least in its own view, was not between regulation or no regulation but was between effective and ineffective regulation.

If, as some consumer interests fear, the new process turns out to be ineffective in the protection of their interests, the way is open for them to challenge the results; as we have pointed out, that way must be kept open. New rates and increases in rates proposed during this interim will be subject to suspension and refund, and so the rights of customers will be fully protected. The new method will also apply in 5(a) proceedings to any existing rate found to be unjust or unreasonable. Refunds cannot be ordered in the latter cases and so consumers bear the disputed rates during the period of the inquiry. But this same situation obtains in the present process of regulation; the application of the new criteria makes no change in this procedural aspect. In the case at bar the Commission has found, after elaborate consideration, that present rates result in deficits to the Company. Consumers have no tenable ground for complaint of such rates. So it seems to us that the interests of consumers are amply protected during this interim period; at least a contrary effect should await the event for us to disturb the view of the Commission, based as it is upon this record.

There remains for discussion a point concerning two 4(e) proceedings which were not terminated. They involved proposed increases based upon escalator clauses in two of Phillips's contracts. These contracts were made before producers such as Phillips were subject to regulation. They were with pipeline companies, as customers, which were subject to regulation. The contracts provided that, if the pipeline companies were granted increases in the rates they could charge, Phillips in turn would receive increases in the rates it charged these customers. These customers had proposed increases, and they were pending in 4(e) proceedings. The Commission ordered that upon decisions in the customers' rate cases Phillips's cases would be acted upon.

Wisconsin and California contend that the Commission should now declare these escalator clauses to be illegal and void as against public policy. As a matter of fact the Commission has declared these clauses to be against the public interest and that they should be held inoperative. But, the Commission says, in so far as these cases of Phillips are concerned, action of the sort demanded by Wisconsin and California is premature. Action on these clauses, it says, should await action on the pending cases which in orderly processes present the problem for decision. We agree with the Commission.

Affirmed.

FAHY, *Circuit Judge, dissenting, with partial concurrence:* I am not able to agree that the order of the Commission terminating the section 4(e)[1] and section 5(a)[2] proceedings should be affirmed. I think the cases should be remanded to the Commission for decision.

While the Commission advances strong reasons for abandoning cost of service as a method of determining the justness and reasonableness of the rates of independent producers of gas, a careful reading of the Commission's opinion demonstrates that the Commission's conclusion that such a method is unworkable follows from a generalized view of the problem of producer rates rather than from the inability of the Commission to utilize the cost of service method in these Phillips cases.

Embarkation upon the area method preferred by the Commission does not necessitate judicial intervention, certainly not at this time; for judicial review must await a Commission order based upon that method. We should not seek to deter the Commission from pursuing such a method in future proceedings, or from using it in any proceedings already initiated along those lines. But it does not follow in my opinion that the Commission should be affirmed in failing to decide the present cases, though it may need to update the record. In the same breath as it were

[1] 52 STAT. 822 (1938), 15 U.S.C. § 717c (1958).

[2] 52 STAT. 823 (1938), 15 U.S.C. § 717d (1958).

in which it describes the unworkability of the cost of service method the Commission itself accepts that precise method in finding that no refunds are to be required in the section 4(e) proceedings, stating:

> While we have found that the rate base method is not an effective means of regulating the producers' prices, evidence in this proceeding was presented almost entirely upon the cost basis and, of course, there were no ceiling prices issued by us at the time of the hearing. There was some field price evidence introduced, but if field prices could be employed in arriving at rates for Phillips, the evidence was incomplete and unrepresentative of Phillips' diverse sales. Therefore we shall proceed on the basis of the evidence adduced in this case to reach conclusions, as reasonable, intelligent and logical as possible even though we know and have herein stated the difficulties inherent in determining a cost of service for Phillips using the rate method. This is clearly a lawful way to determine rates for Phillips as illustrated by the *City of Detroit* case,[11] and under the present record is the only possible method, and therefore we shall make every effort to reach a result by this means.

The Commission could as well have proceeded, with supplemental data, to decide the question of justness and reasonableness of the rates in the section 4(e) proceedings, and, also, to have determined under section 5(a) the just and reasonable rates to be thereafter observed and enforced.

This view is strongly fortified by the able decision of the Presiding Examiner. After an illuminating analysis of the voluminous record made on a cost of service basis he was able to propose definitive decisions. The record had been made with the cooperation of all parties, Phillips itself affirmatively acquiescing in the position that cost of service was the appropriate basis on which to proceed. Phillips' position, as the Examiner points out, was that its jurisdictional rates should be determined upon the basis of an overall cost of service.

[11] *City of Detroit v. F.P.C.*, 230 F. 2d 810 (CADC), *certiorari* denied, 352 U.S. 829.

It is one thing to say, as the Commission does, that the area method should hereafter be adopted, or even adopted in other cases which have not proceeded as far as those before us. It is quite another thing to say that the latter should not be decided under the standards of the Act because the area method was not used in preparing the record. Unless decided Phillips' challenged rates are left undetermined under the standards of the Act since 1948, and apparently will continue to remain undetermined until some future day when new proceedings, now in an inchoate status with no end in sight, are concluded. Difficult and complicated as the tasks of the Commission admittedly are I cannot agree after reading the Examiner's decision or the Commission's findings that the congressional mandate of section 4(e), which requires that these matters shall be decided "as speedily as possible," is being complied with, or that the responsibilities of the Commission under the Act are discharged in the situation resulting from the termination order.

These cases need not be treated as if they were ventures initiated in search of an ideal method of regulating the rates of independent gas producers. Having in mind the history of these proceedings, and the primary congressional purpose of consumer protection, it seems to me that decisions on the present record, supplemented as may be found to be reasonably necessary, would be far more likely to approximate fulfillment of the purposes of the Act than are the termination order and the resulting situation.

The Commission says it has a discretion to terminate as well as to initiate; but once it has exercised its discretion to initiate and has pursued the matter to the extent we find here its discretion to terminate is not as broad as was its discretion to initiate. The former becomes limited by the conditions existing at the time of its exercise. *Minneapolis Gas Co. v. Federal Power Comm'n*, ... U.S. App. D.C. ....., 294 F.2d 212. Compare *Eastern Air Lines, Inc. v. Civil Aeronautics Board*, ... U.S. App. D.C. ....., 294 F.2d 235.

The Commission has actually found Phillips' cost of service on the basis of the record made and has arrived on the same record

at a proper rate of return, stating "this is clearly a lawful way to determine rates for Phillips as illustrated by the *City of Detroit* case, . . . and under the present record is the only possible method . . . ." In this manner the Commission has come so close to doing what it says it should not do as to demonstrate that it is able to do what it has failed to do.

The finding of the Commission in the section 4(e) proceedings that there could be no refunds because the cost of service exceeded the revenues on the basis of the data for the 1954 test year, I think does not justify the order terminating all but two of the section 4(e) proceedings, or the Commission's invitation to Phillips to move to terminate all others which are still pending. The absence of a decision on the issue of justness and reasonableness of rates has the effect of leaving all rates subsequent to 1954 untested under the standards of the Act. Substance is not achieved merely by finding whether or not refunds were due on the basis of the 1954 data. A finding in that regard should not be independent of a finding of the just and reasonable rates. The former should follow from the fact that the just and reasonable rates are not exceeded by those in effect.

The decision of these cases under the standards of the Act not only would not preclude the Commission from embarking upon the area method, but it also would not preclude the Commission from correcting or modifying the decision should the area proceeding show such correction or modification to be desirable; nor do I think a decision on the present record, supplemented as may be needed, would preclude the Commission, pending conclusion of an area proceeding, from establishing guides, formulated, however, with the aid of a decision in the present proceedings.

I agree with Judge Prettyman as to the prematurity of the request for action on two section 4(e) proceedings which have not been terminated.

Appendix B

Administrative Procedure Act, Act of June 11, 1946, c. 324:

SEC. 5. In every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved (1) any matter subject to a subsequent trial of the law and the facts de novo in any court; (2) the selection or tenure of an officer or employee of the United States other than examiners appointed pursuant to section 1010 of this title; (3) proceedings in which decisions rest solely on inspections, tests, or elections; (4) the conduct of military, naval, or foreign affairs functions; (5) cases in which an agency is acting as an agent for a court; and (6) the certification of employee representatives.

* * * * * * *

(b) The agency shall afford all interested parties opportunity for (1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment where time, the nature of the proceeding, and the public interest permit, and (2) to the extent that the parties are unable so to determine any controversy by consent, hearing, and decision upon notice and in conformity with sections 1006 and 1007 of this title. [60 Stat. 239; 5 U.S.C. § 1004].

SEC. 8(b). Prior to each recommended, initial, or tentative decision, or decision upon agency review of the decision of subordinate officers the parties shall be afforded a reasonable opportunity to submit for the consideration of the officers participating in such decisions (1) proposed findings and conclusions, or (2) exceptions to the decisions or recommended decisions of subordinate officers or to tentative agency decisions, and (3) supporting reasons for such exceptions or proposed findings or conclusions. The record shall show the ruling upon each such finding, conclusion, or exception presented. All decisions (including initial, recommended, or tentative decisions) shall become part of the record and include a statement of (1) findings and conclu-

sions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record; and (2) the appropriate rule, order, sanction, relief, or denial thereof. [60 Stat. 242; 5 U.S.C. § 1007(b)]

Natural Gas Act, Act of June 21, 1938, c. 556:

SEC. 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to Senate Resolution 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest. [52 Stat. 821 (1938); 15 U. S. C. § 717 (a)]

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may desig-

nate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided*, That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full

hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 15 U.S.C. § 717c]

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any

rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas. [52 Stat. 823 (1938); 15 U. S. C. § 717d]

SEC. 19. (b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall

be conclusive. If any party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, sec. 1254). [52 Stat. 831 (1938), as amended 15 U.S.C. § 717r (b) (1958)]

PETITION FOR A WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

OCTOBER TERM 1961

No. [redacted] 74

LONG ISLAND LIGHTING COMPANY,
PHILADELPHIA ELECTRIC COMPANY, and
THE UNITED GAS IMPROVEMENT COMPANY, *Petitioners*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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February 28, 1962

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM 1961

No.

LONG ISLAND LIGHTING COMPANY,
PHILADELPHIA ELECTRIC COMPANY, and
THE UNITED GAS IMPROVEMENT COMPANY, *Petitioners*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners, Long Island Lighting Company, Philadelphia Electric Company, and The United Gas Improvement Company, pray that a writ of certiorari issue to review the judgment of United States Court of Appeals for the District of Columbia Circuit, entered in the above-entitled cause on November 30, 1961.

OPINIONS BELOW

The opinion of the Court of Appeals (App. A, *infra*, pp. 1a-23a) is not yet reported. The opinion and order of the Federal Power Commission (R. 251-342) are reported at 24 F.P.C. 537, and the Commission's order denying rehearing (R. 395-404) is reported at 24 F.P.C. 1008. The decision of the presiding examiner (R. 35-217) is reported at 24 F.P.C. 590.

JURISDICTION

The judgment of the Court of Appeals affirming the Commission's orders was entered on November 30, 1961 (App. B, *infra*, p. 24a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and § 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

The question is whether the Federal Power Commission, for reasons of administrative convenience, may indefinitely defer fixing just and reasonable rates for natural-gas producer sales in accordance with proven and established procedures under Sections 4 and 5 of the Natural Gas Act, because it has chosen to embark upon an entirely new, unformulated and judicially untested method of producer rate regulation, when such indefinite deferral will cause massive and irreparable injury to the consuming public.

STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act, 52 Stat. 821, as amended, 15 U.S.C. 717-717w, are set out in Appendix C, *infra*, pp. 25a-28a.

STATEMENT [1]

Petitioners are engaged in the distribution of natural gas to some 1,300,000 customers in the New York and Philadelphia metropolitan areas. Petitioners obtain their natural gas requirements from certain interstate gas pipeline companies, which in turn purchase, either directly or indirectly, the major part of their natural gas supplies from independent natural gas producers, including Phillips Petroleum Company. Accordingly, the rates charged by Phillips and other independent producers directly affect petitioners' gas costs and the rates which they must charge the ultimate domestic consumer.

When the Federal Power Commission reinstituted the general investigation of Phillips' rates pursuant to the mandate of this Court in *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672, petitioners herein were permitted to intervene in the proceedings and participated actively in all phases. Petitioners presented testimony and other evidence bearing on the appropriate methods for determining Phillips' costs. The regulatory methods sponsored by petitioners were adopted in large part by the Examiner and the Commission in determining Phillips' ~~part by the Examiner and the Commission in determining Phillips'~~ 1954 costs in its decision here (R. 90, 94).

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[1] Petitioners have been permitted to read the petition for a writ of certiorari seeking to review the judgment of the court below filed concurrently herewith by petitioners State of Wisconsin, Public Service Commission of Wisconsin, and Public Service Commission of the State of New York (hereafter Wisconsin-New York petition). Petitioners are in full agreement with the statement appearing at pages 3-10 of that petition, and to avoid burdening the Court with repetitious matter, they would hereby incorporate and adopt that statement in this petition, as though fully set out herein.

When the Commission in its opinion herein (R. 251, 323-329) determined not to fix Phillips' just and reasonable rates, for past and future periods, on this record (augmented if necessary) and terminated the proceedings, petitioners, together with the States of Wisconsin, New York and California, sought review in the Court of Appeals. That court, Judge Fahy dissenting, while emphasizing the major importance of the question, sustained the Commission's action abandoning, for an indefinite period, any effort to regulate the rates of Phillips, as well as other major independent gas producers, under Sections 4 and 5(a) of the Natural Gas Act.

This petition followed.

REASONS FOR GRANTING THE WRIT

The court below has affirmed a conscious decision by the Federal Power Commission to defer for an indefinite period—as the court states, possibly as long as 14 years—regulation of independent producers under Sections 4 and 5(a) of the Natural Gas Act (App. C, *infra*, pp. 25a-28a). The court's reasons are twofold (App. A, *infra*, pp. 14a-19a): first, that the Commission's current administrative difficulties make mandatory such a moratorium on regulation; and second, that the Commission will be able to provide interim protection to consumers against exorbitant gas field prices by applying the untested price levels in its Statement of General Policy 61-1, which are themselves, as Dean Landis has noted, "approximately [the] current maximum prices, which have more than doubled in the past five years."[2]

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[2] Landis, Report on Regulatory Agencies to the President-elect, p. 55, 1960. See Wisconsin-New York petition, Appendix D.

The Commission, however, has repeatedly disavowed either the intention or ability to utilize current maximum and wholly untested field prices in order to set *just and reasonable* rates for independent producers during the interim period, pending development of an area approach to regulation (R. 346; Wisconsin-New York petition, pp. 14-15). The decision below is thus grounded on a basic misconception as to the Commission's ability to protect users of natural gas, in the event the Commission is permitted to abandon its existing and well-advanced regulatory program for testing major producer rates under Sections 4 and 5(a) of the Act.

There can be no doubt that consumers will be left unprotected by the Commission's inaction. Gas field prices have more than doubled during the past 10 years and a very substantial volume of jurisdictional gas sales is now being made by producers at untested and inflated price levels with no possibility of refunds or retroactive reduction. (Wisconsin-New York petition, pp. 23-26). Thus, any substantial delay in the testing of these prices means probable consumer loss—an injury compounded each month regulation is deferred (Wisconsin-New York petition, App. C.)

This Court told the Commission in its *Catco* decision (360 U.S. 378) that it could not defer control of sharply increased *initial* field prices under Section 7 of the Natural Gas Act, pending development of a regulatory method under Sections 4 and 5(a) of that Act. The Commission equally does not have the discretion under *Catco* to delay indefinitely that regulation under Sections 4 and 5(a) when such delay could result in serious consumer injury.

Petitioners are not oblivious to the Commission's administrative difficulties, and have endeavored to cooperate in developing an effective method of producer regulation in the pending and projected area rate proceedings. Petitioners strongly urge, however, that the gas consumers which they serve today are entitled to some protection against virtually unregulated current gas field prices. Granting that protection, as Judge Fahy recognized (App. A, *infra*, 22a-23a), would not cripple the Commission in its search for another method of regulation. It follows that the Commission has exceeded the allowable bounds of its discretion in deciding, for reasons of administrative convenience, to defer effective regulation of existing prices for as much as a decade in the future.

CONCLUSION

There can be no dispute that the question is of major and general importance. The decision conflicts sharply with decisions of this and other Courts of Appeals. It is also demonstrable that delay in clarifying the Commission's regulatory responsibility would only compound the injury to the public which will almost certainly flow from the Commission's abdication of regulatory responsibility. It follows that a resolution of the issue here presented should not be left to a divided Court of Appeals or deferred to future developments.

For the above reasons, as well as the reasons set forth in the Wisconsin-New York petition filed concur-

rently herewith, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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February 28, 1962

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16175

STATE OF WISCONSIN AND PUBLIC SERVICE COMMISSION OF WISCONSIN, PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT
PHILLIPS PETROLEUM COMPANY, INTERVENOR

No. 16177

LONG ISLAND LIGHTING COMPANY, et al., PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT
PHILLIPS PETROLEUM COMPANY,
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, INTERVENORS

No. 16180

PEOPLE OF THE STATE OF CALIFORNIA and PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT
PHILLIPS PETROLEUM COMPANY, INTERVENOR

On Petitions for Review of Order of the Federal Power Commission

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Decided November 30, 1961

Before PRETTYMAN, FAHY and DANAHER, *Circuit Judges*

PRETTYMAN, *Circuit Judge:* Some controversies concern major problems of general application. Others concern only a limited set of circumstances. The case at bar is of the former variety. The questions are posed by complicated procedural difficulties. They concern the procedures of the Federal Power Commission in dealing with the rates of natural gas producers.

The Phillips Petroleum Company is a producer of natural gas. It procures gas from several widely separated and widely differing areas. It explores for, develops, produces, purchases, gathers and processes gas and oil. It sells gas to pipeline companies [1] under contracts negotiated by it and these customers. The contracts differ in such terms as delivery conditions, water content, hydrocarbon content, place of delivery, pressure, and price.

Two sections of the Natural Gas Act [2] are involved. One (Section 4(e)) provides in essence as to sales subjected to regulation by the Commission, that when a rate or an increased rate is filed the Commission may suspend it for five months, meantime setting it for hearing. When such a rate goes into effect after the period of suspension (the Commission not having concluded its consideration), the funds derived from the newly-filed rates may be impounded

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[1] It also sells oil, products condensed from gas, and other petroleum products and chemicals. It sells natural gas in several conditions. It sells to customers other than pipelines as well.

[2] 52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-717w.

and, in so far as the Commission fails to approve them, may be refunded. The burden of proving in such a proceeding that an increased rate is "just and reasonable" rests upon the company. The other section of the statute (5(a)) provides in essence that either upon a complaint or upon its own motion the Commission may inquire into an existing rate. If that rate be found unlawful the Commission must determine what shall thereafter be deemed a just and reasonable rate. Its decision becomes effective from its date. No refund is involved.

In October, 1948, the Commission instituted a proceeding under Section 5(a), the latter of the above sections, concerning Phillips's rates. In that proceeding it decided it had no jurisdiction over the rates of producers of natural gas. This court reversed the Commission,[3] and the Supreme Court affirmed our decision.[4] The Commission reinstated its 5(a) proceeding.

Meantime and thereafter Phillips filed increased rates in respect to many of its contracts. The Commission suspended them and set them for hearing, under Section 4(e) of the statute, the first of the two sections above discussed. Many purchasers, many contracts, many rate schedules, and many filings were involved. Thus many 4(e) proceedings, under different docket numbers, were instituted. As time went on, Phillips filed further proposed increases in some of these same rates. In such event the earlier proposed rate would, if approved, cover a limited period, *i.e.*, until the succeeding increase in that same contract rate was filed. A period thus limited is called a "locked-in period" in the jargon of the industry. These later increases were also suspended by the Commission. Thus many proceedings under Section 4(e) involving rates of Phillips became pending.

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[3] State of Wisconsin v. Federal Power Comm'n, 92 U.S. App. D.C. 284, 205 F.2d 706 (1953).

[4] Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

The Commission consolidated the 5(a) proceeding and twelve of the 4(e) proceedings for hearing. These twelve 4(e) proceedings involved an aggregate of about five and a half million dollars in proposed increased rates. The proposed rates ranged from 5¼ cents per Mcf to 13½ cents per Mcf. The proceeding was long, detailed, and resulted in a voluminous record of testimony and exhibits. The Examiner rendered a long (174 printed pages), careful and complete initial decision. He approached the problem from the standpoint of cost-of-service[5] and rate base. Many perplexing problems were presented. He examined them all and decided them. Among them were different approaches to cost-of-service, the allocation of production costs, the allocation of exploration costs, the problem of natural gas liquids, the rate base, adjustment to the test year, the computation of the income tax component, the proper rate of return, working capital, allocations between jurisdictional and non-jurisdictional sales, field prices, a discussion of system-wide as compared with area rates. Upon all these the Examiner made detailed findings and conclusions, displaying commendable patience and grasp of the subject matter. He adopted a system-wide approach and found that Phillips's total jurisdictional cost of service, properly computed, was $57,280,218 for the test year,[6] or an average unit cost of 11.662 cents per Mcf. He recommended that Phillips be ordered to calculate a maximum rate for gas with certain described qualities at such level that, when applied to the sales volume for all jurisdictional contracts, adjusted for approved delivery condition differentials, would produce revenues roughly equal to the system-wide cost of service. He recommended that Phillips be ordered to file, with full

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[5] Cost-of-service in this context includes not only operating expenses, taxes, exploration allowances, and gas purchases but also a fair return on the rate base.

[6] Compared with 92.3 million dollars claimed by Phillips.

explanations, a list of rates so calculated. Those calculated rates would be subject to approval by the Commission. He recommended that the rates thus calculated and approved be applied in both the 4(e) and the 5(a) proceedings, *i.e.* to both suspended and future rates.

The Commission reversed the Examiner. Its decision and findings were also extended and exhaustive (82 printed pages, plus exhibits). One Commissioner dissented in respect to the computation of the cost of service; otherwise he concurred. Basically, the Commission concluded "beyond any doubt, that the traditional original cost, prudent investment rate base method of regulating utilities is not a sensible, or even a workable method of fixing the rates of independent producers of natural gas." It pointed out critical differences between pipeline operations and producer operations, quoting from opinions by Mr. Justice Harlan and Mr. Justice Jackson, and saying that in regulating producers it is faced with problems entirely different from those of an ordinary public utility. It pointed out that simply to allow producers a return on investment would penalize the efficient or fortunate and reward the inefficient or unfortunate. Only where a producer purchases a fully developed acreage at a fair price does his investment have a real relationship to his return. The producer who first takes the risk in an area and proves it productive pays less for his rights than those who come later. But he must invest his funds before he knows whether he will have anything to sell or not. Mr. Justice Jackson once wrote that "there is little more relation between the investment and the result than in a game of poker."

The Commission pointed out that a producer of natural gas also produces oil, the price of which is unregulated, makes sales (intrastate, etc.) not subject to Commission jurisdiction, and sells products also excluded. Thus "extremely difficult" problems of allocating costs are involved.

It commented that none of the experts proposed allocations acceptable to other experts. "Ridiculous results will be reached among the great number of producers and owners of interests if costs should be the only basis for regulation." It referred to the fact that much of Phillips's gas is purchased from thousands of independent producers whose rates are under percentage-type casing-head contracts, dependent on Phillips's rates. The interests of the many royalty owners must also be considered. Another problem is the administrative burden of full cost rate cases for each of thousands of independent producers. Adherence to cost rate-base methods results in necessity for a full-scale company-wide cost study to determine the proper price in any one contract. At the time of this Commission decision 3372 independent producers had rates on file. Five hundred seventy producers were involved in 3278 proposed rate increases under suspension and awaiting hearing. Of eleven rate increase cases in which full hearings had been had and decisions rendered, ten showed the increases justified. A special problem prevented decision in the other. In the three 5(a) cases theretofore completed, the producers' prices were found justified. Rigid adherence to the rate-base method would in many cases price the producers' gas out of the market. "From the foregoing, it follows that effective regulation of the price of natural gas must be on some more manageable plan than the rate base method. Thus it is clear that the better method would be to establish fair prices for the gas itself and not for each individual producer."

Simultaneously with the foregoing opinion the Commission promulgated a "policy statement" setting forth rate guidance schedules for various producing areas. These schedules consisted of two rates prescribed for each of twenty-three producing areas throughout the country (except for two areas, for which only one rate was given). One rate was for initial service, *i.e.*, new contracts, in the area. The other was for increases in rates, *i.e.*, proposals

for increases in existing contracts, in the area. For example, in the first area listed (Texas District No. 1) an initial service rate of 15.0 cents per Mcf was given and an increased rate level of 14.0 cents per Mcf. The Commission described its preparation of these schedules thus:

> "In arriving at the price levels for the various areas set forth in the appendix to this statement, we have considered all of the relevant facts available to us. Such consideration included cost information from all decided and pending cases, existing and historical price structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas. Of necessity, we have not set forth the adjustments to these prices which must be made to take into account every possible provision of every contract which may affect the actual price, such as Btu adjustments, conditions of delivery, etc. The relevance of such adjustments to the basic contract price and the appropriate established price standard must be considered as each filing is made."

The proposed use of this list was described by the Commission as follows:

> "• • • These standards will serve as a guide to us and to interested parties in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended.
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> "These price levels, as announced by Appendix A attached to this statement, are for the purpose of guidance and initial action by the Commission and their use will not deprive any party of substantive

rights or fix the ultimate justness and reasonableness of any rate level."[7]

In its opinion the Commission said further: "This schedule of prices is only for guidance and does not constitute any determination of just and reasonable rates and will not foreclose any person from justifying a particular rate in any area." The schedule is of maximum acceptable rates for gas from a given area, as opposed to rates established for each rate filing by each producer after a full cost-rate base consideration of each rate so filed.

The Commission disposed of the consolidated cases before it in three parts. The first part consisted of the superseded rates of the prior periods ("locked-in" periods). The second consisted of the presently current rates and those to be in effect during the interim period from now until the newly proposed area-rate system is completely designed and put into effect. The third part consisted of rates for the future after the completion and inauguration of the area-rate system.

Before we consider these several dispositions in detail we must understand the problem with which the Commission was dealing. The rates proposed to be increased in these 4(e) proceedings are not the rates of utilities in the traditional sense, such as pipelines. The rates here involved are the charges made by companies which buy or produce a product, process it to suit the requirements of a customer, and sell it to that customer under a contract. The product is procured from many different places, from Texas to West Virginia, from Louisiana to Wyoming. In its raw state it is of many different contents. Different customers require different terms as to the physical qualities of the delivered article, points and

[7] Statement of General Policy No. 61-1, Sept. 28, 1960, 25 Fed. Reg. 9578 (Oct. 5, 1960).

terms of delivery, and other factors. Hundreds of producers, hundreds of contracts, and thousands of rate filings are involved.

When we use the terms "cost of service" or "rate base" in this context, we must be careful of the meaning we intend. There is a system-wide cost of service. This would be, as the words indicate, a computation for the entire Phillips system. But even so it would not be a computation for all Phillips operations, because the Company has many operations, such as those in petro-chemical fields, and sales of all sorts of petroleum products, and many sales not subject to federal regulation under present statutes. In fact the Company's gross income from sales of natural gas in 1955 was less than six per cent of its total gross income. So even a system-wide computation of cost of service for sales of natural gas subject to Commission regulation requires monumental allocations of many costs, such as exploration costs, taxes, administration expenses, purchases, extraction costs, sales of residue gas and liquids, and so on. Nevertheless such a computation was made. The Examiner and also the Commission determined and used a system-wide cost of service. As found by the Commission the system-wide cost of service for Phillip's sales of natural gas subject to Commission jurisdiction in the test year 1954 was $55,548,054, or 11.309 cents per Mcf. But even the figure thus carefully computed was subject to adjustment for purchased gas costs, gathering taxes, and royalties. The same observations apply to the rate base on a system-wide basis. One was determined by the Commission.

Then, theoretically at least, there is a cost of service for each contract, if not for each rate, and so for each 4(e) proceeding. But nobody, so far as we are advised, contends that any such computations could be made with any meaningful results by any known method. The results of any such effort would be pure guesswork, involv-

ing a vast multiplication of the arbitrary allocations which would have to be made.

The Examiner did not attempt to make any cost-of-service determination on individual contract, rate, or case basis. He determined a system-wide cost of service, which gave him a nationwide average unit cost of 11.662 cents per Mcf. He then proposed that "[b]ased on the system-wide cost of service herein approved, as set forth in Appendix Table 12 hereof, Phillips shall calculate the 'maximum rate for 1,000-pound, sweet, dehydrated, and gathered gas,' at such level that its application to the sales volumes delivered in 1954 under each and every one of the 1954 jurisdictional contracts, as adjusted for the approved delivery condition rate differentials, will produce total revenues roughly equal to such system-wide cost of service." He proposed further that "Phillips shall file with the Commission a statement of such 'maximum rate,' including a clear and detailed explanation as to the manner in which it was calculated, together with a list of *calculated rates* for all of its jurisdictional rate schedules then in effect." The Commission, as we have said, reversed the Examiner, treating the case, in effect, in three parts.

1. As to the first part of the problem, the 4(e) proceedings, dealing with suspended proposals now superseded, the Commission made system-wide conclusions as to jurisdictional sales and applied them to these cases. It found $45,568,291 of revenues against $55,548,054* cost of service. This showed a system-wide deficit of some $9,000,000 on jurisdictional sales of natural gas. The Commission noted that no evidence had been presented to show that the different rates in these different (4(e)) proceedings were unduly discriminatory or preferential, which notation, translated, means that any adjustment in

* Modified to $54,525,315 after rehearing.

these rates should be correspondingly proportionate in respect to each and all. The Commission applied the result of its system-wide calculations to each and all of the 4(e) proceedings and concluded that no refunds were due. Having thus ordered, it concluded ("terminated") the proceedings.

The Commission made no determination of the cost of service of each of these contract rates separately; it had no evidence before it upon which it could make such determinations, and it was of opinion that such computations would be unworkable and foolish under the circumstances.

In these 4(e) cases, as we have pointed out, the Commission was dealing with a locked-in period. The revenues derived from the rates at issue had been impounded. The only question of substance in respect to that period was whether refunds should be made. The Commission decided that question, flatly and directly. No other question remained in those cases for decision. They presented no questions as to rates to be charged. Each presented the question whether a refund was due that customer for the past period and, if so, how much. Having made three determinations—(1) that there was a deficit of some $9,000,000 a year in revenues against cost of service, (2) that the increases involved totaled about five and a half million dollars and so, if allowed in full, would not wipe out the operating deficit, and (3) that any adjustments should be proportionate to all contract rates—it concluded that no refund was due on any contract, *i.e.*, in any 4(e) proceeding. Section 4(e) pertinently says that the Commission "may" order a refund of "the portion of such increased rates or charges by its decision found not justified." We cannot say that a deficit justifies or requires a refund or that the Commission was unlawfully arbitrary in reaching that result from the premises.

We think the Commission's course was reasonable and tenable. Surely, if only a single rate had been involved,

and enough evidence were introduced to justify, under testing, a conclusion that the company was operating at a deficit under that rate, it would not be necessary that evidence be taken to establish the precise penny amount of the deficit in order to support a reasonable inference by the Commission that no refund was indicated. Of course, in the matter at bar a number of rates in separate cases were involved, but the principle of procedure and the scope of permissible inferences from basic facts are much the same as in the suggested illustration. We think the facts support the conclusion.

It is argued that the Commission did not declare the rates under consideration to be just and reasonable or the contrary; that, instead, it "terminated" the proceeding. The contention is that the Commission made no decision. We think the point is not well taken. The Commission did make a clear decision, after elaborate findings, upon the one substantive issue before it. It did say it "terminated" the proceedings, but it terminated them after deciding the basis and dispositive issue, and it entered an order on that decision. Its "termination" was much like that of a judge after he had rendered findings, conclusion and judgment.

Whether the Commission should have preceded its ultimate conclusion of no-refund with an intermediate conclusion of justness and reasonableness in the rates at issue, and whether it properly added the termination order to its decisive finding, seem to us to be immaterial queries. The important feature is that the Commission reached and decided the critical substantial issue, rationally and upon detailed findings of basic facts upon an ample record.

This is not a *Minneapolis Gas*[9] situation, in which the Commission did nothing but simply terminated the pro-

[9] Minneapolis Gas Company v. Federal Power Commission, —— U.S. App. D.C. ——, 294 F.2d 212 (D.C.Cir. 1961).

ceeding without passing upon any of the disputed issues before it.

2. The case yields to clearer treatment if we next consider the part of the Commission's treatment which is last in chronological order, that is, the determination of rates for the future. As to these rates the Commission embarked upon the formulation of a new method of fixing just and reasonable rates for producers. It inaugurated hearings for that purpose. We think we need not explore the possibilities of success in that venture, or stop here to describe the projected scheme previously outlined in this opinion. In general it is referred to as an area-price method: it aims to establish proper prices for the gas rather than for the seller thereof. The Congress has confided the regulation of the natural gas industry to the Commission, not to the courts. The Supreme Court has said several times that the Commission is not bound to any one method or to known methods. The regulation of gas producers is a new project. Obviously, as is cogently pointed out in this record, it presents new and complex facts and problems. It would be foolish for the courts to hold that the Commission is bound to apply to these new conditions the methods and measurements designed and used for other and different regulatory purposes. We think it is clear that the Commission had ample authority to embark upon an effort to design suitable new standards for use in the regulation of producers when it found that the tools at hand were not suited to this purpose. The Commission abandoned the pending 5(a) proceeding in which it had been endeavoring to establish rates for the future by methods it now deems inadequate. We see no reason why it should not have done so.

3. The difficult part of the case before us concerns the second, or middle, part of the Commission's disposition. This involves the rates for the period from 1959 until the new system—or a new system—is designed and established.

This period will be long, estimates running from four to fourteen years. The rates during this period may, theoretically, be (1) rates in effect without increases having been proposed after January 1, 1959, (2) rates proposed to be increased since that date and suspended under Section 4(e), (3) rates for which increases may be proposed after the present time, (4) initial rates, *i.e.*, rates under new contracts made after January 1, 1959.

To meet the need for interim regulation the Commission took several steps. It published the policy statement which we have described. That announcement contained several components. First, the Commission said that in determining its own *sua sponte* action in respect to rates (*i.e.*, suspending proposed increases or inaugurating inquiries into existing rates) it would be guided by the guide rates. Second, it said that persons attacking rates (*i.e.*, customers and consumers) would be required to present evidence as to the industry generally in the area concerned, as well as the traditional evidence relating to the individual producer involved. Third, it said that "[a]s experience and changing factors may indicate," it would change the areas designated and likewise change the guide prices. Fifth, [sic] it said it will use its guide rates in disposing of 4(e) (*i.e.*, suspended proposed increases) proceedings arising upon increases proposed since January 1, 1959.

Refraining from exploring the various arguments, and argumentative trails, pointed out to us by the parties, we come directly to the crux of this problem. Has the Commission power under the Natural Gas Act to do what it did? Can it adopt upon the basis of its own expertise and its files, without a record made in the open in respect to the specific subject matter in issue, and without hearing, a set of guide lines by which it will be controlled in its regulatory functions during an interim period while it is attempting to perfect a suitable system for permanent regulation? We think it can.

In the first place, and throughout, we must remember that the Congress has power to direct the regulation of interstate commerce, and it has placed that regulatory power over natural gas in the Power Commission. We must remember that the problem at bar concerns a regulatory power. We are not considering adjudicatory, or quasi-judicial, power. It has long since been established that rate-making is a legislative function, and it is so defined in the Administrative Procedure Act.

Regulation poses many difficult problems. New regulation poses acutely difficult problems. Solutions oftentimes develop slowly. Many illustrations of that fact could be called to mind.

What power has the Commission in respect to interim regulation while the permanent structure is being designed and erected? Must it use means and methods long established for use in respect to other and different regulatory necessities? Or may it design from its own judgment and accumulated data a new method designed for the new problem? The differences between a public utility, such as a pipeline rendering a service by means of a fixed plant and operation, and a producer, who discovers or buys a product where, when and under such terms as he may, and sells that product under contracts negotiated on the open market, are too evident to justify elaboration. Whether the method thus designed and put into use by the Commission is good or bad is no part of our problem. Our inquiry is whether it was within the orbit of statutory authority and whether it was within constitutional limitations. We turn to those questions.

The Natural Gas Act is broad in its bestowal of power. It declares that all rates demanded by a company in connection with the sale of gas in interstate commerce for resale shall be just and reasonable. Section 4(a). A gas company files with the Commission schedules of its rates. Section 4(c). If a company proposes to increase a rate,

it must file a new schedule. The Commission may then enter upon a hearing concerning the "lawfulness" of the proposed rate. Section 4(e). If the Commission, on its own motion or upon complaint, finds a rate unjust, unreasonable, unduly discriminatory or preferential, the Commission "shall" determine the just and reasonable rate. Section 5(a). Of course, constitutional restrictions apply; rates fixed by governmental authority cannot be confiscatory; all procedures must be by due process, that term conveying meanings differing according to the basic nature of the proceeding but always including that which is fair and decent according to the standards of our social order and time.

The statute contains no definition of a "just and reasonable" rate. It is established by tradition and by many court decisions that for a public utility, rendering service by use of fixed equipment, a just and reasonable rate is one which returns a fair profit upon the investment, or which supplies the utility with adequate revenues to command needed funds upon an economically reasonable basis. But what of a fair price for a commodity bought and sold by a merchandiser? Almost the whole of the economics of merchandizing differs from the economics of public utility service. Are the just and reasonable prices of such a merchandiser limited to fair returns on his own investment and prices paid by him (and, if so, what investment and what prices), or are those prices reasonably measured by the fair prices for the product as measured by the open competitive market for the product, evaluated by Commission expertise and data on the whole of the market operation? Either criterion is a method of regulation. It seems to us that the choice must lie with the Commission.

Let us emphasize that we do not have before us at this time the question whether any rate set by the Commission as a guide rate falls within the area of reasonable computation. That question is emphatically left open by

the Commission, and by us, for consideration when some one or more of the selected guide rates is attacked, by a producer, a customer, or a consumer. The problem here at this time is merely whether the Commission may embark upon this method of regulation. Since it is the Commission's judgment that this method is best suited for the regulation of these prices, for the determination of their justness and reasonableness, we find in the statute nothing to deny a trial of the method.

Of course, conceivably, justness and reasonableness from the standpoint of the consumer might be defined as limiting the vendor's return to a fair amount on his investment, and his price accordingly. But, if the government agency charged with the responsibility in the public interest finds, after elaborate accumulation of data, that such a measurement is unworkable, may not a fair price for the product reflected on the open market, after scrutiny and adjustment by the government agency concerning the factors which produced that price, be just and reasonable for the consumer? Of course the agency would be required to be alert for artificial impulses in such a fair area price, and the avenues of attack by consumers would have to be kept open without obstruction; but, if the latter is avowed, how could we assume in advance that the agency would not protect the consumer as it is charged by the Congress to do? The Commission is not here proposing to accept a field price, or any other price as is. It has announced guideline rates which it deems to be, on the basis of the internal data in its files on all the operators in the several areas, fair rates for the product in those areas. Such rates, thus determined, would seem to be just and reasonable rates for the consumers of the product. And, similarly, they would seem to be just and reasonable charges for the producers to make.

As to the constitutional question of confiscation, it would seem to us that the question should await proof presented

by a producer in respect to a particular rate in a particular area.

Thus we come to conclude that the interim method of regulation proposed by the Commission does not appear at this point in the process to be violative of either statutory or constitutional limitations.

It is urged upon us that the Commission has abandoned regulation of these rates for this interim period. We do not agree with the view. It has certainly changed the method of regulation, or, more precisely, the standards by which it will apply its regulatory power. It has abandoned case-by-case, contract-by-contract measurements on a cost-of-service rate-base basis. It has installed an area fair price measurement for the prices of the product to be sold. In so doing it has abandoned a method it finds to be unworkable and foolish in favor of a method it deems to be workable and just and reasonable. If that be so, instead of abandoning regulation it is making regulation effective. The choice it faced, at least in its own view, was not between regulation or no regulation but was between effective and ineffective regulation.

If, as some consumer interests fear, the new process turns out to be ineffective in the protection of their interests, the way is open for them to challenge the results; as we have pointed out, that way must be kept open. New rates and increases in rates proposed during this interim will be subject to suspension and refund, and so the rights of customers will be fully protected. The new method will also apply in 5(a) proceedings to any existing rate found to be unjust or unreasonable. Refunds cannot be ordered in the latter cases and so consumers bear the disputed rates during the period of the inquiry. But this same situation obtains in the present process of regulation; the application of the new criteria makes no change in this procedural aspect. In the case at bar the Commission has found, after elaborate consideration, that pres-

ent rates result in deficits to the Company. Consumers have no tenable ground for complaint of such rates. So it seems to us that the interests of consumers are amply protected during this interim period; at least a contrary effect should await the event for us to disturb the view of the Commission, based as it is upon this record.

There remains for discussion a point concerning two 4(e) proceedings which were not terminated. They involved proposed increases based upon escalator clauses in two of Phillips's contracts. These contracts were made before producers such as Phillips were subject to regulation. They were with pipeline companies, as customers, which were subject to regulation. The contracts provided that, if the pipeline companies were granted increases in the rates they could charge, Phillips in turn would receive increases in the rates it charged these customers. These customers had proposed increases, and they were pending in 4(e) proceedings. The Commission ordered that upon decisions in the customers' rate cases Phillips's cases would be acted upon.

Wisconsin and California contend that the Commission should now declare these escalator clauses to be illegal and void as against public policy. As a matter of fact the Commission has declared these clauses to be against the public interest and that they should be held inoperative. But, the Commission says, in so far as these cases of Phillips are concerned, action of the sort demanded by Wisconsin and California is premature. Action on these clauses, it says, should await action on the pending cases which in orderly processes present the problem for decision. We agree with the Commission.

Affirmed.

FAHY, *Circuit Judge, dissenting, with partial concurrence:* I am not able to agree that the order of the Commission terminating the section 4(e)[1] and section 5(a)[2] proceedings should be affirmed. I think the cases should be remanded to the Commission for decision.

While the Commission advances strong reasons for abandoning cost of service as a method of determining the justness and reasonableness of the rates of independent producers of gas, a careful reading of the Commission's opinion demonstrates that the Commission's conclusion that such a method is unworkable follows from a generalized view of the problem of producer rates rather than from the inability of the Commission to utilize the cost of service method in these Phillips cases.

Embarkation upon the area method preferred by the Commission does not necessitate judicial intervention, certainly not at this time; for judicial review must await a Commission order based upon that method. We should not seek to deter the Commission from pursuing such a method in future proceedings, or from using it in any proceedings already initiated along those lines. But it does not follow in my opinion that the Commission should be affirmed in failing to decide the present cases, though it may need to update the record. In the same breath as it were in which it describes the unworkability of the cost of service method the Commission itself accepts that precise method in finding that no refunds are to be required in the section 4(e) proceedings, stating:

> While we have found that the rate base method is not an effective means of regulating the producers' prices, evidence in this proceeding was presented almost entirely upon the cost basis and, of course, there were no ceiling prices issued by us at the time of the

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[1] 52 Stat. 822 (1938), 15 U.S.C. § 717c (1958).

[2] 52 Stat. 823 (1938), 15 U.S.C. § 717d (1958).

hearing. There was some field price evidence introduced, but if field prices could be employed in arriving at rates for Phillips, the evidence was incomplete and unrepresentative of Phillips' diverse sales. Therefore we shall proceed on the basis of the evidence adduced in this case to reach conclusions, as reasonable, intelligent and logical as possible even though we know and have herein stated the difficulties inherent in detemining a cost of service for Phillips using the rate method. This is clearly a lawful way to determine rates for Phillips as illustrated by the *City of Detroit* case,[11] and under the present record is the only possible method, and therefore we shall make every effort to reach a result by this means.

[11] *City of Detroit* v. *F.P.C.*, 230 F. 2d 810 (CADC), *certiorari* denied, 352 U.S. 829.

The Commission could as well have proceeded with supplemental data, to decide the question of justness and reasonableness of the rates in the section 4(e) proceedings, and, also, to have determined under section 5(a) the just and reasonable rates to be thereafter observed and enforced.

This view is strongly fortified by the able decision of the Presiding Examiner. After an illuminating analysis of the voluminous record made on a cost of service basis he was able to propose definitive decisions. The record had been made with the cooperation of all parties, Phillips itself affirmatively acquiescing in the position that cost of service was the appropriate basis on which to proceed. Phillips' position, as the Examiner points out, was that its jurisdictional rates should be determined upon the basis of an overall cost of service.

It is one thing to say, as the Commission does, that the area method should hereafter be adopted, or even adopted in other cases which have not proceeded as far as those before us. It is quite another thing to say that the latter

should not be decided under the standards of the Act because the area method was not used in preparing the record. Unless decided Phillips' challenged rates are left undetermined under the standards of the Act since 1948, and apparently will continue to remain undetermined until some future day when new proceedings, now in an inchoate status with no end in sight, are concluded. Difficult and complicated as the tasks of the Commission admittedly are I cannot agree after reading the Examiner's decision or the Commission's findings that the congressional mandate of section 4(e), which requires that these matters shall be decided "as speedily as possible," is being complied with, or that the responsibilities of the Commission under the Act are discharged in the situation resulting from the termination order.

These cases need not be treated as if they were ventures initiated in search of an ideal method of regulating the rates of independent gas producers. Having in mind the history of these proceedings, and the primary congressional purpose of consumer protection, it seems to me that decisions on the present record, supplemented as may be found to be reasonably necessary, would be far more likely to approximate fulfillment of the purposes of the Act than are the termination order and the resulting situation.

The Commission says it has a discretion to terminate as well as to initiate; but once it has exercised its discretion to initiate and has pursued the matter to the extent we find here its discretion to terminate is not as broad as was its discretion to initiate. The former becomes limited by the conditions existing at the time of its exercise: *Minneapolis Gas Co.* v. *Federal Power Comm'n*, —— U.S. App. D.C. ——, 294 F.2d 212. Compare *Eastern Air Lines, Inc.* v. *Civil Aeronautics Board*, —— U.S. App. D.C. ——, 294 F.2d 235.

The Commission has actually found Phillips' cost of service on the basis of the record made and has arrived

on the same record at a proper rate of return, stating "this is clearly a lawful way to determine rates for Phillips as illustrated by the *City of Detroit* case, . . . and under the present record it is the only possible method . . . ." In this manner the Commission has come so close to doing what it says it should not do as to demonstrate that it is able to do what it has failed to do.

The finding of the Commission in the section 4(e) proceedings that there could be no refunds because the cost of service exceeded the revenues on the basis of the data for the 1954 test year, I think does not justify the order terminating all but two of the section 4(e) proceedings, or the Commission's invitation to Phillips to move to terminate all others which are still pending. The absence of a decision on the issue of justness and reasonableness of rates has the effect of leaving all rates subsequent to 1954 untested under the standards of the Act. Substance is not achieved merely by finding whether or not refunds were due on the basis of the 1954 data. A finding in that regard should not be independent of a finding of the just and reasonable rates. The former should follow from the fact that the just and reasonable rates are not exceeded by those in effect.

The decision of these cases under the standards of the Act not only would not preclude the Commission from embarking upon the area method but it also would not preclude the Commission from correcting or modifying the decision should the area proceeding show such correction or modification to be desirable; nor do I think a decision on the present record, supplemented as may be needed, would preclude the Commission, pending conclusion of an area proceeding, from establishing guides, formulated, however, with the aid of a decision in the present proceedings.

I agree with Judge Prettyman as to the prematurity of the request for action on two section 4(e) proceedings which have not been terminated.

APPENDIX B

On Petitions for Review of Order of the
Federal Power Commission

Before: Prettyman, Fahy and Danaher, Circuit Judges.

Judgment

These cases came on to be heard on the record from the Federal Power Commission, and were argued by counsel.

On Consideration Whereof, It is ordered and adjudged by this court that the order of the Federal Power Commission on review in these cases is affirmed.

Per Circuit Judge Prettyman

Dated: November 30, 1961

Separate dissenting opinion by Circuit Judge Fahy, with partial concurrence.

APPENDIX C

Natural Gas Act

The pertinent provisions of the Natural Gas Act of June 21, 1938, c. 556, 52 Stat. 821; as amended, 15 U.S.C. §§ 717-717w, are as follows:

Section 4 (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * * * * * * * * *

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and in the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative, without complaint, at once, and if it so orders without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon

a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided*, That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions prefer-

ence over other questions pending before it and decide the same as speedily as possible.

[52 Stat. 822 (1938); 15 U.S.C. § 717e]

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Section 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

[52 Stat. 823 (1938); 15 U.S.C. § 717d]

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Section 19. (a) . . .

(b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by

filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure to do so. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

[52 Stat. 831 (1938) as amended, Aug. 28, 1958, Pub. L. 85-791, § 19, 72 Stat. 947, 15 U.S.C. § 717r.]